COVER SHEET

SEC Registration Number

PW-102

Company Name

MANILA ELECTRIC COMPANY

Principal Office (No./Street/Barangay/City/Town)Province)

LOPEZ BUILDING, ORTIGAS AVENUE,
BRGY UGONG, PASIG CITY

Form Type	Department requiring the report	Secondary License Type, If Applicable
17-Q		

COMPANY INFORMATION

Company's Email Address	Company's Telephone Number/s	Mobile Number
N/A	6312222/16220	N/A

No. of Stockholders	Annual Meeting Month/Day	Fiscal Year Month/Day
43,671	Last Tuesday of May	December 31

CONTACT PERSON INFORMATION

The designated contact person ***MUST*** be an Officer of the Corporation

Name of Contact Person	Email Address	Telephone Number/s	Mobile Number
Atty. William S. Pamintuan	wspamintuan@meralco.com.ph	632-8014	N/A

Contact Person's Address

Lopez Building, Ortigas Avenue, Brgy. Ugong, Pasig City

Note: In case of death, resignation or cessation of office of the officer designated as contact person, such incident shall be reported to the Commission within thirty (30) calendar days from the occurrence thereof with information and complete contact details of the new contact person designated.

SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES REGULATION CODE AND SRC RULE 17(2)(b) THEREUNDER

1. **For the quarterly period ended:** *June 30, 2018*

2. **Commission identification number:** *PW-102*

3. **BIR Tax Identification Code:** *000-101-528-000*

4. **Exact name of issuer as specified in its charter:** *Manila Electric Company*

5. **Country of Incorporation:** *Philippines*

6. **Industry Classification: (SEC use only)**

7. **Address of issuer's principal office:** *Lopez Building, Ortigas Avenue, Barangay Ugong, Pasig City*
   Postal Code: *1605*

8. **Issuer's Telephone Numbers including area code:** *(+632) 631-5567*

9. **Former name, former address and former fiscal year, if changed since last report:** *N/A*

10. **Securities registered pursuant to Sections 8 and 12 of the Code, or Sections 4 and 8 of RSA:**

Title of Each Class	Number of Shares of Common Stock Outstanding
Common Stock	1,127,098,705
Debt Securities – bonds	Amount of Debt Outstanding PhP18,500 million Fixed Rate Notes • ₱11,500 million – 7Y Note due 2020 • ₱7,000 million – 12Y Note due 2025

11. Are any or all of these Securities listed on a Stock Exchange?

Yes [x] No [ ]

If yes, the name of such Stock Exchange and the class/es of Securities:

Philippine Stock Exchange

12. Indicate by check mark whether the registrant:

(a) has filed all reports required to be filed under Section 17 of the Code and SRC Rule 17 thereunder or Sections 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding twelve (12) months (or for such shorter period that the registrant was required to file such reports):

Yes [x] No [ ]

(b) has been subject to such filing requirements for the past ninety (90) days:

Yes [x] No [ ]

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

The 1H 2018 Financial Statements is hereto attached and made integral part of this report.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Please refer to the attached 1H 2018 Management's Discussion and Analysis of Financial Condition and Results of Operations.

PART II – OTHER INFORMATION

Not applicable.

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has caused this report to be signed on its behalf by the undersigned duly authorized representatives.

MANILA ELECTRIC COMPANY
Issuer

WILLIAM S. PAMINTUAN
First Vice President
Assistant Corporate Secretary &
Information Disclosure Officer

BETTY C. SIY-YAP
Senior Vice President &
Chief Finance Officer

Date: August 14, 2018

Cc: Disclosure Department
Listings and Disclosure Group
Philippine Stock Exchange

Issuer Compliance and Disclosure Department
Philippine Dealing & Exchange Corp.

Management's Discussion and Analysis of Financial Position and Results of Operations

The following discussion and analysis of financial position and results of operations of Manila Electric Company ("*MERALCO*") and its subsidiaries, collectively referred to as the *"MERALCO Group*" should be read in conjunction with the unaudited interim consolidated financial statements as at June 30, 2018 and December 31, 2017 and for the six months ended June 30, 2018 and 2017. The consolidated financial statements have been prepared in compliance with the Philippine Financial Reporting Standards (*"PFRS")*. *PFRS* includes statements named *PFRS* and Philippine Accounting Standards, including Interpretations issued by the *PFRS* Council.

The financial information appearing in this report and in the accompanying unaudited interim consolidated financial statements is presented in Philippine peso, *MERALCO Group'*s functional and presentation currency, as defined under *PFRS*. All values are rounded to the nearest million pesos, except when otherwise indicated. The exchange rate used to translate U.S. dollars to Philippine peso in this report and in the accompanying unaudited interim consolidated financial statements is US$1.00 to ₱53.34, the closing rate as at June 29, 2018 (the last trading day for the six months ended June 30, 2018) quoted through the Philippine Dealing System.

Financial Highlights and Key Performance Indicators

(Amounts in millions, except earnings per share, and operational data)	**June 30, 2018** (Unaudited)	**December 31, 2017** (Audited)	**Increase (Decrease) Amount**	**%**
Condensed Statements of Financial Position				
Total assets	₱323,960	₱303,355	₱20,605	7
Current assets	104,527	98,432	6,095	6
Cash and cash equivalents	50,778	45,937	4,841	11
Equity attributable to equity holders of the parent	75,118	73,610	1,508	2
Total debt	39,882	40,256	(374)	(1)
Current liabilities	113,217	105,839	7,378	7

	Unaudited			
	Six Months Ended June 30		**Increase (Decrease)**	
	2018	**2017**	**Amount**	**%**
Condensed Statements of Income				
Revenues	₱150,544	₱141,032	₱9,512	7
Costs and expenses	136,861	127,543	9,318	7
Other income, net of expenses	1,848	1,100	748	68
Income before income tax	15,531	14,589	942	6
Net income	11,997	10,568	1,429	14
Net income attributable to equity holders of the parent	11,973	10,501	1,472	14
Earnings per share attributable to equity holders of the parent	10.62	9.32	1.3	14
Condensed Statements of Cash Flows				
Net cash provided by operating activities	21,461	14,201	7,260	51
Net cash used in investing activities	(7,560)	(4,331)	(3,229)	75
Net cash used in financing activities	(9,060)	(10,800)	1,740	16
Operational Data				
Number of customer accounts (in thousands):				
Residential	5,879	5,666	213	4
Commercial	503	493	10	2
Industrial	10	10	–	–
Streetlight	5	5	–	–
Electricity sales volume (in *GWh*)	21,665	20,338	1,327	7
System loss [1]:				
MERALCO	5.71%	6.11%	-0.40%	(7)
Clark Electric Distribution Corporation ("*CEDC*")	2.57%	2.76%	-0.19%	(7)

[1] Based on 12-month moving average

The Key Performance Indicators ("*KPI*") of *MERALCO* are as follows:

Financial KPI	**Definition**	**June 30, 2018** (Unaudited)	**December 31, 2017** (Audited)
Debt to Equity	Total debt / Equity attributable to equity holders of the parent	0.53	0.55
Current Ratio	Current assets / Current liabilities	0.92	0.93

		Unaudited	
		Six Months Ended June 30	
		2018	**2017**
Profit Margin	Net income attributable to equity holders of the parent / Revenues	8%	7%
Return on Equity	Net income attributable to equity holders of the parent / Equity attributable to equity holders of the parent	16%	14%
Asset Turnover	Revenues / Average total assets	0.48	0.47

OVERVIEW

MERALCO is the Philippines' largest electric power distribution company, with franchise area covering 9,685 square kilometers. It provides power to almost 6.5 million customer accounts in 36 cities and 75 municipalities, which include Metro Manila, all of the provinces of Rizal, Cavite and Bulacan, and parts of the provinces of Pampanga, Batangas, Laguna and Quezon. Turnover of business establishments in the franchise area accounts for more than 50% of the country's Gross Domestic Product (*"GDP")*.

CEDC, a 65%-owned subsidiary of *MERALCO*, holds the power distribution franchise for the Clark Special Economic Zone (*"CSEZ")* in Clark, Pampanga. The *CEDC* franchise area covers 320 square kilometers and it serves 2,173 customer accounts as at June 30, 2018. *CEDC* is a registered private distribution utility granted by Clark Development Corporation ("*CDC*") a franchise to own, operate and maintain a power distribution system and to distribute power exclusively within its franchise area, which includes the Clark Freeport Zone and the sub-zone as determined pursuant to Presidential Decree No. 66 and the Joint Venture Agreement executed between *CDC* and Meralco Industrial Engineering Services Corporation ("*MIESCOR*") dated February 19, 1997.

The *MERALCO Group*'s business is grouped into two (2) segments, namely, power and other services.

- Power

  The Power segment consists of (a) electricity distribution, (b) power generation and (c) retail electricity supply ("*RES*").

  Electricity distribution – This is principally electricity distribution and supply of power on a pass-through basis covering all captive customers in the *MERALCO* and the *CEDC* franchise areas in Luzon. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s franchise area covers Clark Special Economic Zone and the sub-zone.

  Power generation – The *MERALCO Group*'s re-entry into power generation is through investments in operating companies or participation in the development of power generation projects. *MERALCO* PowerGen Corporation ("*MGen*"), the power generation arm of the *MERALCO Group*, has a 14% equity interest in Global Business Power Corporation ("*GBPC*"). *GBPC* owns a total of 854 MegaWatt ("*MW*") (gross) of coal and diesel-fired power plants.

  MGen owns an effective 28% equity in PacificLight Power Pte Ltd. ("*PacificLight Power*") in Jurong Island, Singapore. *PacificLight Power* owns and operates a 2 x 400 *MW* liquefied natural gas ("*LNG*") power plant which began commercial operations in February 2014.

  MGen, through San Buenaventura Power Ltd. Co. ("*SBPL*"), is constructing a 455 *MW* (net) super-critical coal-fired power plant in Mauban, Quezon. The Power Supply Agreement ("*PSA*") with *MERALCO* was approved by the Energy Regulatory Commission ("*ERC*") on May 19, 2015. Target commercial operations date is third quarter of 2019.

  MGen is developing a 2 x 600 *MW* (net) ultra super-critical pulverized coal-fired power plant in Atimonan, Quezon through Atimonan One Energy, Inc. ("*A1E*"). A *PSA* has been executed between *A1E* and *MERALCO* for the full capacity. The regulatory hearing process at the *ERC* for the *PSA* had long been completed and *A1E* has filed its Formal Offer of Evidence ("*FOE*") on March 8, 2017. Evaluation of the short-listed Engineering, Procurement and Construction ("*EPC*") contractors has been concluded and negotiations to finalize arguments with the contractors are ongoing. *A1E* has also secured on Environmental Compliance Certificate ("*ECC*") and has been issued a Certificate of Registration as a preferred enterprise by the Board of Investments ("*BOI*"). The expected completion of the first unit is 2021 and the second 600 *MW* by early 2022.

  MGen is also developing a 2 x 300 *MW* (net) Circulating-Fluidized Bed ("*CFB*"), coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. ("*RP Energy*").

In April 2016, *RP Energy* signed separate *PSA*s with *MERALCO* and Aboitiz Energy Solutions, Inc. ("*Aboitiz Energy*"). *RP Energy* is awaiting the approval of its *PSA* with *MERALCO* by the *ERC*.

On December 22, 2016, *RP Energy* signed a loan agreement with three (3) local banks for the ₱31.5 billion project financing. The approval of the *PSA* between *RP Energy* and *Aboitiz Energy* by the *ERC* is a condition precedent to the first loan drawdown. As at July 30, 2018, the *PSA* was not yet approved by the *ERC* which restricted *RP Energy* to issue a notice to proceed to the *EPC* contractor and led to *RP Energy*'s inability to achieve financial close.

Site preparation of the first 300 *MW* unit has been completed, with expected commercial operations in the second half of 2021. The second phase shall follow within 12 months, subject to progress of *NGCP*'s *RoW* acquisition for the new transmission line that will connect the second phase to the grid.

On April 27, 2016, *MGen* and Semirara Mining and Power Corporation entered a joint venture agreement to develop a 2 x 350 *MW* sub-critical pulverized coal-fired power plant in Calaca, Batangas. The development and operations shall be undertaken by *St. Raphael*, the joint venture entity. A *PSA* was signed by *St. Raphael* and *MERALCO* in April 2016 for the 400 *MW* of the plant's capacity. The *PSA* is pending approval by the *ERC*. Development activities for the project are ongoing and target commercial operations of the power plant is in 2021.

MGen has 49% equity interest in Mariveles Power Generation Corporation ("*Mariveles Power*") which is developing a 4 x 132 *MW* coal-fired power plant in Bataan.

MERALCO has a 50% equity interest in Pure Meridian Hydropower Corporation ("*Pure Meridian*"), which is primarily engaged in the development of mini-hydroelectric power projects.

RES – This covers the sourcing and supply of electricity to qualified contestable customers. *MERALCO* and *CEDC* serve as a local retail electricity suppliers within their franchise area under a separate business unit, *MPower* and Cogent Energy, respectively. Qualified contestable customers who opt to switch to contestability and elects to be among contestable customers may source their electricity supply from any retail electricity supplier, including *MPower* and Cogent Energy.

The *ERC* granted the following subsidiaries distinct *RES* licenses to operate as retail electricity suppliers within Luzon and Visayas: Vantage Energy Solutions and Management, Inc. ("*Vantage*"), a wholly-owned subsidiary of *MERALCO*; Solvre, Inc., ("*Solvre*") a wholly owned subsidiary of *MGen*; MeridianX Inc. ("*MeridianX*"), a wholly owned subsidiary of Comstech Integration Alliance, Inc. ("*Comstech*"), on January 10, 2017, February 9, 2017 and February 9, 2017, respectively. Clarion Energy Management, Inc. ("*Clarion*"), a wholly owned subsidiary of *CEDC*, has submitted the requirements for its *RES* licensing to the *ERC*. As at July 30, 2018, the approval of the *RES* license for *Clarion* is pending with the *ERC*.

- Other Services

The other services segment pertains principally to the following electricity-related services: electro-mechanical engineering, construction, consulting and related manpower services, e-transaction and bills collection, telecoms services, rail-related operations and maintenance services, insurance and re-insurance, e-business development, power distribution management, energy systems management, harnessing renewable energy and electric vehicle and charging infrastructure solutions. These services are provided by *MIESCOR*, Miescor Builders, Inc., and Miescor Logistics, Inc. (collectively known as "*MIESCOR Group*"), Corporate Information Solutions, Inc. *("CIS")*, CIS Bayad Center, Inc. *("Bayad Center"),* Customer Frontline Solutions, Inc. ("*CFS*") and Fieldtech Specialist, Inc. (collectively referred to as "*CIS Group*"), eMeralco Ventures, Inc. ("*e-MVI")*, Paragon Vertical Corporation and Radius Telecoms, Inc. (collectively referred to as "*e-MVI Group*"), MRAIL, Inc. *("MRail")*, Republic Surety and Insurance Company, Inc. ("*RSIC*"), Lighthouse Overseas Insurance Limited *("LOIL"),* Meralco Financial Services, Inc. *("Finserve")*, Meralco Energy, Inc. ("*MServ"), Comstech*, MSpectrum, Inc. ("*Spectrum*") and eSakay, Inc. ("*eSakay*").

Below is the summary of *MERALCO Group*'s business segments:

BUSINESS SEGMENTS	
Power	**Other Services**
Electricity distribution • *MERALCO* • *CEDC* Power generation • *MGen* and its subsidiaries • *Pure Meridian* *RES* • *MERALCO* through *MPower* business unit • *CEDC* through *Cogent Energy* business unit • *Vantage* • *Solvre* • *MeridianX* • *Clarion*	• *CIS Group* • *Comstech* • *e-MVI Group* • *eSakay* • *Finserve* • *LOIL* • *MIESCOR Group* • *MRail* • *MServ* • *RSIC* • *Spectrum*

RESULTS OF OPERATIONS

The tables below summarize the consolidated results of operations and the contribution of each business segment to *MERALCO Group*'s revenues, costs and expenses, other income, and net income.

	Unaudited			
	For the Six Months Ended June 30, 2018			
	Power[2]	Other Services	Inter-segment Transactions	Consolidated
	(Amounts in millions)			
Revenues	₱146,903	₱4,667	(₱1,026)	₱150,544
Costs and expenses	134,183	3,721	(1,043)	136,861
Other income (expense) - net	1,913	(49)	(16)	1,848
Net income attributable to equity holders of the parent	11,368	629	(24)	11,973

	Unaudited			
	For the Six Months Ended June 30, 2017			
	Power[3]	Other Services	Inter-segment Transactions	Consolidated
	(Amounts in millions)			
Revenues	₱137,409	₱4,464	(₱841)	₱141,032
Costs and expenses	124,740	3,644	(841)	127,543
Other income (expense) - net	1,132	(32)	-	1,100
Net income attributable to equity holders of the parent	10,040	528	(67)	10,501

2018 compared with 2017

REVENUES

The following table shows the composition of *MERALCO Group'*s consolidated revenues by business segment.

	Unaudited					
	For the Six Months Ended June 30					
	2018		2017		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[4]	₱146,903	98	₱137,409	98	₱9,494	7
Other services	4,667	3	4,464	3	203	5
Inter-segment transactions	(1,026)	(1)	(841)	(1)	(185)	22
Total	**₱150,544**	**100**	**₱141,032**	**100**	**₱9,512**	**34**

Consolidated electric revenues, which accounted for 98% of total revenues, grew by 7% compared with the same period last year as a result of the combined effects of (a) 7% increase in volume of energy sold; and (b) increase in generation charge brought about by higher fuel prices, the weakening of the peso vis-à-vis the U.S. dollar to ₱53.34:US$1 as at June 30, 2018 from ₱50.47:US$1 as at June 30, 2017, the higher local Consumer Price Index ("*CPI*"), and higher prices in the Wholesale Electricty Spot Market ("*WESM*"). The average distribution rate of *MERALCO* was ₱1.42 per *kWh*, ₱0.01 lower than 2017, as the sales mix reflected a slightly higher share of Industrial over Residential volume.

[2] *Principally electricity distribution*
[3] *Ibid*
[4] *Ibid*

Non-electric revenues, which accounted for 3% of consolidated revenues, remains stable compared with last year. Non-electric revenues consist largely of revenues from subsidiaries operations.

Power

Revenues from the power segment consist of distribution and pass-through components, which include generation, transmission, subsidies, and other charges related to energy trading. *MERALCO* and *CEDC* distribute electricity to industrial, commercial and residential customers while *MPower*, *Vantage* and *Cogent Energy* supply electricity to their respective contestable customers.

The average *MERALCO* retail price for the first half of 2018 was at ₱8.83 per *kWh*, with generation charge being the largest component at 56%. Transmission, distribution, system loss, and taxes and universal charges (including the increased Feed-in-Tariff Allowance or "*FIT-All*") represented 10%, 16%, 4% and 14% of the average retail price, respectively.

Average generation charge to consumers was ₱4.94 per *kWh*, ₱0.49 per *kWh* or 11% higher than the average rate in the same period last year. Transmission charge was at Peso 0.84 per *kWh* in 2018, 2% higher than the Peso 0.82 per *kWh* in 2017. Average *SL* rate was at Peso 0.36 per *kWh*, Peso 0.04 per *kWh* or 13% higher than the average rate in the same period last year.

MERALCO's Net System Input ("*NSI*") was 22,942 *GWh* for the first six months of 2018. Contracted natural gas plants accounted for 38% of *NSI*. *MERALCO*'s contracted coal-fired plants provided 31% of the *NSI*, while 31% of *NSI* represented volume sourced from a mix of hydro, geothermal, renewable, oil and other non-*MERALCO* contracted coal-fired plants. Average purchased power cost was at ₱5.92 per *kWh*, 8% higher than in 2017 as a result of the extended scheduled maintenance of certain coal-fired plants, higher global prices of fuel and the weakening of the Philippine peso.

SL performance of *MERALCO* for the 12-month period ended June 30, 2018 was at its 115-year "record best" of 5.71%, 1.79 percentage points lower than the applicable regulatory *SL* cap (inclusive of 1% assumed typical sub-transmission and substation technical losses) which took effect starting June 2018, as mandated by the *ERC* in its Resolution No. 10, Series of 2018.

Distribution revenues increased by 3% mainly due to the growth in energy sales volume by 7%. This was mitigated by the decrease in the average distribution rate to ₱1.42 per *kWh*, lower by ₱0.01 compared with last year as the sales mix reflected higher share of industrial customers over residential volume.

The following table summarizes the customer count as at June 30, 2018 and 2017 and the corresponding energy sales volume per customer class for the six months ended June 30, 2018 and 2017:

	No. of Customers		**Electricity Sales**		**% Change**	
	(in thousands)		*(in GWh)*			
Customer Class	**2018**	**2017**	**2018**	**2017**	**No. of Customers**	**Electricity Sales**
Residential	5,947	5,667	6,715	6,333	5%	6%
Commercial	506	493	8,502	8,045	3%	6%
Industrial	10	10	6,379	5,893	–	8%
Streetlights	5	4	69	67	25%	3%
Total	**6,468**	**6,174**	**21,665**	**20,338**	**5%**	**7%**

MERALCO's customer base grew by almost 5% to 6.5 million by the end of June 2018, as new connections across all customer classes increased by 294 thousand year-on-year. In the first half of 2018, there were a total of 142 thousand (136 thousand in the first half of 2017) net new connections, reflecting an average of more than 23 thousand new customers per month. New residential connections were the highest at 135 thousand, with commercial at seven thousand and industrial at 120.

Consolidated electricity sales volumes grew by 7% year-on-year to 21,665 *GWh*, following a strong first quarter of 2018 where volumes surged by 9% over the comparative period to 10,145 *GWh*. On a monthly basis, while June 2018 sales volumes were at 3,969 *GWh*, reflecting a mild 3% growth, it is the highest ever volume wheeled in a month in *MERALCO*'s 115-year operations. This is consistent with historical performance where June is the strongest sales month for the period. *MERALCO*'s system peak demand for the first half of 2018 was at 7,399 *MW* recorded on May 23, 2018, up 6% over the 6,973 *MW* on June 14, 2017.

MERALCO's industrial sales volumes grew by 9% to 6,249 *GWh* year-on-year, representing 29% of total *GWh* distributed. Growth was led by semiconductor, food and beverage, and rubber and plastics industries. The local and international quick service restaurants ("*QSRs*") drove the rubber and plastics industry volume growth of 11% versus its comparative volume in 2017 as the demand for plastic and plastic alternative packaging increased both for food and non-food products. In addition, the higher fuel prices and the weakening of the peso pushed manufacturers to source power from the grid rather than run their oil-fired generators. Revenues from exports of the semiconductor industry continued to increase, albeit at a lower rate of 4% as some companies are in a "wait and see" mode pending further amendments under the Tax Reform for Acceleration and Inclusion ("*TRAIN*") Law 2 and talks of charter change. The 4% growth in the food and beverage industry comes from staple meat product plants as well as dressing plants for *QSR*s.

Residential sales volume of *MERALCO* increased by 6% to 6,712 *GWh* due to new accounts and the ramp-up from accounts energized in 2017. The municipalities of Rosario and San Pedro in the provinces of Cavite and Laguna, respectively, as well as the cities of Alabang, Muntinlupa, Taguig, Las Piñas and Parañaque, which constitute a significant area in the south section of the *MERALCO* franchise area, contributed the highest growth in residential energy sales volumes. New customers, higher temperatures and inflation continue to be the drivers for residential volumes. In the first six months of 2018, substantially lower real feel temperature at 35.1ºC (1.8ºC less than in the same period in 2017) and higher June 2018 inflation at 5.3% (the highest since October 2011) caused organic sales growth to be lower than in the same period in 2017. As at June 30, 2018, total residential energy sales represented 31% of total sales volumes.

MERALCO's commercial sales volume grew 6% year-on-year to 8,379 *GWh*. Real estate, retail trade, and hotels and restaurants contributed most to the sales volume growth. The Philippine Offshore Gaming Operators ("*POGO*s") continue to be a major growth factor for both commercial and residential real estate sector. Total office space transactions in Metro Manila further expanded as new licenses were issued by the Philippine Amusement and Gaming Corporation ("*PAGCOR*") in the first half of 2018. In 2017, a large share of the total office space transactions in Metro Manila were for *POGO*s, which expanded by 6% as of the first half of 2018. The *POGO*s have also spurred the growth in related industries such as retail outlets and condominium occupancy with the increasing number of Chinese nationals operating these eCasino businesses. On the other hand, office space take-up for Business Process Outsourcing ("*BPO*") was lower by 22% due to delayed approval of such spaces as Philippine Economic Zone Authority ("*PEZA*")-qualified locations. The increase in energy sales for retail trade also came from several new malls and mixed-use complexes inaugurated and opened in 2017. Energy sales from hotels and restaurants continue to expand as operations normalized for newly opened establishments. Commercial sales volume represents 39% of total volume distributed.

As at June 30, 2018, a total of 95,731 prepaid electricity ("*PRES*") customers have been activated, with year-to-date average per capita kiloWatthour ("*AkPU*") at 140 *kWh*, which is 6% higher than the same period last year. The increasing migration to urban areas to support the services sector drove condominium units-occupancy. Cumulative churn rate is less than 2% or a total of 1,465 customers, to date.

Energy sales volumes for Clark Electric Distribution Corporation ("*CEDC*") for the first six months of 2018 was at 257 *GWh*, 9% lower than in 2017, as *CEDC* opted to have a major customer secure its distribution service from Clark Development Corporation ("*CDC*"). Normalized for the effect of this transfer of service of such locator to *CDC*, total energy sales volumes grew by 8% or 20 *GWh*, indicative of increased business activities within the Clark Economic Zone. Average generation rate was at ₱5.24 per *kWh*.

Other Services

Non-electric revenues consists mainly of business generated by (i) foreign attachment to the *MERALCO* poles; and (ii) revenues from subsidiaries, which include (a) *MIESCOR* and its subsidiaries from its *EPC*, and operations and maintenance works involving various substations and transmission/telecommunications lines, which would have generated higher revenues, save for the delayed award of certain projects; (b) *MServ* for the supply and installation of powerhouse, load side and substation equipment, and energy efficiency services; (c) *Bayad Center* handling payment collections for 277 corporate and government billers in over 9,100 sites and collection partners, spot billing volumes, remittances and other fee-based transactions; and (d) Radius Telecoms, Inc. ("*Radius*") with higher recurring revenues as a result of an expanding customer base and high service reliability.

COSTS AND EXPENSES

Consolidated costs and expenses for the six months ended June 30, 2018 amounted to ₱136,861 million, higher by ₱9,318 million compared with ₱127,543 million in 2017. The following table shows the breakdown of consolidated costs and expenses by business segment:

	Unaudited					
	For the Six Months Ended June 30					
	2018		2017		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
			(Amounts in millions)			
Power[5]	₱134,183	98	₱124,740	98	₱9,443	8
Other services	3,721	3	3,644	3	77	2
Inter-segment transactions	(1,043)	(1)	(841)	(1)	(202)	24
Total	**₱136,861**	**100**	**₱127,543**	**100**	**₱9,318**	**7**

Power

Costs and expenses of power segment for the six months ended June 30, 2018 amounted to ₱134,183 million, 8% higher compared with ₱124,740 million in the same period in 2017. The details of costs and expenses are summarized in the following table:

	Unaudited					
	For the Six Months Ended June 30					
	2018		2017		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
			(Amounts in millions)			
Purchased power	₱116,330	87	₱107,683	86	₱8,647	8
Salaries, wages and employee benefits	5,264	4	5,188	4	76	1
Depreciation and amortization	3,390	2	3,271	3	119	4
Contracted services	2,963	2	2,872	2	91	3
Others	6,236	5	5,726	5	510	9
Total	**₱134,183**	**100**	**₱124,740**	**100**	**₱9,443**	**8**

Purchased power accounted for 87% of the total costs and expenses for the six months ended June 30, 2018. All of the electricity distributed by *MERALCO* and *CEDC* are contracted through *PSA*s with generators and long-term Power Purchase Agreements *("PPA")* with Independent Power Producers ("*IPP*"). The remaining balance is purchased from the *WESM*.

The purchased power cost for the six months ended June 30, 2018 increased by 8% due to (i) increased prices of coal, oil and gas; (ii) depreciation of Philippine peso versus U.S. dollar; and (iii) higher *WESM* prices due to outages of a number of baseload plants and the strong demand particularly during peak hours.

[5] *Ibid.*

The total power purchased in 2018 was 18,944 *GWh* at ₱5.92 per *kWh* compared with 18,977 *GWh* at ₱5.50 per *kWh* in 2017. The volume of energy purchased under long-term *PPA*s with *IPPs*, namely, First Gas Corporation *("FGPC")*, *FGP* Corp. *("FGP")* and Quezon Power (Philippines) Limited Co. *("QPPL")*, represents 28% of *MERALCO*'s Net System Input ("*NSI*"). Purchases from power generators under *PSA*s, and other special programs accounted for 49%, while purchases from *WESM* accounted for 12% of *NSI*.

Contracted services increased by 3% from ₱2,872 million for the six months ended June 30, 2017 to ₱2,963 million in the same period in 2018 on account of higher spending for information system/information technology services, cloud subscriptions and consultancy for various system enhancements and customer-centric projects. Customer-related expenses such as collection services and meter reading services also increased due to growth in number of customer accounts.

Other expenses consist of business taxes and permits, provision for probable losses and expenses from claims, provision for doubtful accounts, costs of materials, transportation, and other corporate expenses.

Other Services

Costs and expenses of other services business segment for the six months ended June 30, 2018 amounted to ₱3,721 million, 2% lower compared with ₱3,644 million in the same period in 2017.

	Unaudited					
	For the Six Months Ended June 30					
	2018		2017		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Salaries, wages and employee benefits	₱1,393	37	₱1,370	38	₱23	2
Contracted services	783	21	768	21	15	2
Depreciation and amortization	224	6	191	5	33	17
Others	1,321	36	1,315	36	6	1
Total	**₱3,721**	**100**	**₱3,644**	**100**	**₱77**	2

Salaries, wages and employee benefits increased by ₱23 million due to increase in manpower count and project-hired personnel of *Bayad Center*, *Radius* and *MServ*, and annual merit increase of employees.

OTHER INCOME

The following table shows the breakdown of other income (expenses) by business segment:

	Unaudited			
	For the Six Months Ended June 30			
			Increase/Decrease	
	2018	2017	Amount	%
	(Amounts in millions)			
Power[6]	₱1,913	₱1,132	₱781	69
Other services	(49)	(32)	(17)	53
Intersegment transactions	(16)	–	(16)	(100)
Total	**₱1,848**	**₱1,100**	**₱748**	**68**

[6] *Ibid.*

Power

Breakdown of other income (expenses) of power segment is as follows:

	Unaudited			
	For the Six Months Ended June 30			
			Increase/Decrease	
	2018	2017	Amount	%
	(Amounts in millions)			
Interest and other financial income	₱1,191	₱1,061	₱130	12
Interest and other financial charges	(992)	(717)	(275)	38
Equity in net earnings (losses) of associates and joint ventures	(138)	269	(407)	(151)
Foreign exchange gains	1,493	262	1,231	470
Others	359	257	102	40
Total	**₱1,913**	**₱1,132**	**₱781**	69

Interest and other financial income increased by ₱130 million due to higher interest rates resulting in higher yields of investments this period compared with the same period last year.

Interest and other financial charges increased by ₱275 million in 2018 compared with the same period last year as a result of (i) higher interest rates; and (ii) accounting adjustments to recognize accretion of deemed interest.

NET INCOME ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The following table shows the breakdown of net income attributable to equity holders of the parent by business segment:

	Unaudited					
	For the Six Months Ended June 30					
	2018		2017		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[7]	₱11,368	93	₱10,040	96	₱1,328	13
Other services	629	7	528	5	101	19
Inter-segment transactions	(24)	–	(67)	(1)	43	(64)
Total	**₱11,973**	**100**	**₱10,501**	**100**	**₱1,472**	**14**

Net income attributable to equity holders of the parent for the six months ended June 30, 2018 increased by 14% as a result of (i) higher electricity sales volume as compared to same period last year; (ii) managed operating and maintenance expenses with the delayed regulatory reset process; (iii) adjustment of provisions for impairment of certain receivables; and (iv) foreign exchange adjustments to reflect the effect of devaluation of peso against US dollar.

CHANGES IN FINANCIAL POSITION

Utility Plant and Others

The ₱3,106 million increase in utility plant and others reflects completed construction of new electric distribution-related facilities and upgrade in major rehabilitation of existing electrical facilities totaling to about ₱6,480 million, net of depreciation and amortization of ₱3,333 million for the period.

[7] *Ibid.*

Deferred Tax Assets

The increase in deferred tax assets mainly represents tax effect of provisions recognized for the six months ended June 30, 2018.

Other Noncurrent Assets

Other noncurrent assets increased mainly due to net under-recoveries of pass-through charges recognized during the period as a result of increasing prices of pass-through charges.

Cash and Cash Equivalents

The increase in cash and cash equivalents was mainly due to cash generated from operations amounting to ₱21,461 million offset by net cash used in investing activities of ₱7,560 million, and net cash used in financing activities of ₱9,060 million.

Trade and Other Receivables

Trade and other receivables increased mainly due to the higher average customer retail rate in June 2018 compared with the average retail rate in December 2017.

Other Noncurrent Liabilities

Other noncurrent liabilities pertain to estimated liabilities for claims and statutory matters. Additional obligations were recognized during the period.

Trade and Other Current Liabilities

The increase in trade and other current liabilities represents impact of higher purchased power liabilities from increased *kWh* purchased and higher generation cost in June 2018.

2017 compared with 2016

REVENUES

The following table shows the composition of *MERALCO Group*'s consolidated revenues by business segment.

	Unaudited					
	For the Six Months Ended June 30					
	2017		**2016**		**Increase/Decrease**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
	(Amounts in millions)					
Power[8]	₱137,409	98	₱124,769	97	₱12,640	10
Other services	4,464	3	4,817	4	(353)	(7)
Inter-segment transactions	(841)	(1)	(782)	(1)	(59)	(8)
Total	**₱141,032**	**100**	**₱128,804**	**100**	**₱12,228**	**9**

Consolidated electric revenues, which accounted for 98% of total revenues, grew by 10% mainly on account of the 3% growth in volume of energy sold. The pass-through revenues grew by 12% compared with the same period in 2016 due to higher overall average generation charge, which is a result of higher fuel cost of natural gas-fired power plants during the 20-day maintenance shutdown of the Malampaya gas facilities and the extended maintenance outages of certain coal-fired power plants and depreciation of Philippine peso versus U.S. dollar in 2017. The increase was partially offset by lower overall retail revenues of *MPower* and *Vantage* as a result of the temporary disruption in commercial operations and intensified competition in the *RES* market.

Non-electric revenues, which accounted for 3% of consolidated revenues, decreased by 7% as volume of transactions from *MServ*, *MIESCOR*, *RSIC*, *Comstech* and *MRail* were lower compared with 2016.

[8] *Ibid*

The decrease was partially offset by (i) increased bills payment volumes from *Bayad Center* from over 6,700 sites and collection partners supplemented by spot billing volumes; and (ii) higher recurring revenues of *Radius* as a result of expanding customer base and high service reliability.

Power

Revenues from the power segment consist of generation, transmission, distribution, subsidies and other charges related to electricity distribution and trading revenues of *MPower* and *Vantage*. *MERALCO* and *CEDC* distribute electricity to industrial, commercial and residential customers while *MPower* and *Vantage* supply electricity to their respective contestable customers.

Generation charge, which is the single largest component, represents 61% of electricity revenues for the six months ended June 30, 2017. The average generation charge to captive customers was at ₱4.71 per *kWh* for the six months ended June 30, 2017 against ₱3.95 per *kWh* in the same period in 2016. Transmission charge represents 12% of the electricity revenues or equivalent to ₱0.83 per *kWh* for the six months ended June 30, 2017, 9% lower compared with ₱0.90 per *kWh* in the same period in 2016.

The higher generation charges are attributable to (i) higher fuel cost of natural gas-fired power plants during the maintenance shutdown of the Malampaya gas facilities, (ii) extended maintenance outages of certain coal-fired power plants, and (iii) continuous depreciation of Philippine peso versus U.S. dollar in 2017.

Distribution revenues, which accounted for 21% of the total electricity revenues, increased by 3% due to the growth in energy sales volume at 3%.

The *MERALCO*'s 12-month moving average *SL* rate was at its "record best" at 6.11% as at June 30, 2017. This is 2.39 percentage points below the *SL* regulatory cap of 8.50%, and 0.35 percentage points lower than the *SL* rate for the same period in 2016. *CEDC*'s 12-month moving average *SL* rate was at 2.42%, 6.08 percentage points below the regulatory cap and 1.48 percentage points lower than the same period last year.

The following table summarizes the customer count as at June 30, 2017 and 2016 and the corresponding energy sales volume per customer class for the six months ended June 30, 2017 and 2016:

	No. of Customers		**Electricity Sales**		**% Change**	
	(in thousands)		*(in GWh)*			
Customer Class	**2017**	**2016**	**2017**	**2016**	**No. of Customers**	**Electricity Sales**
Residential	5,666	5,415	6,333	6,173	5	3
Commercial	493	480	8,045	7,758	3	4
Industrial	10	10	5,893	5,719	–	3
Streetlights	5	5	67	67	–	–
Total	**6,174**	**5,910**	**20,338**	**19,717**	4	3

MERALCO's customer base grew by 4% to almost 6.2 million customer accounts, 136 thousand more since December 2016. Residential and commercial customer accounts rose by 5% and 3%, respectively. Residential customers continue to represent 92% of the total customer accounts.

Growth in energy sales volume continued, albeit at a slower 3% level coming from a high base in 2016. The growth is due to the expansion in *MERALCO*'s customer base and strong consumer spending spurred by inward remittances from overseas Filipinos and the continuing growth of the Business Processing Outsourcing ("*BPO*") industry.

Residential sales volumes grew by 3%, relatively slower compared with 4% in the same period last year. The growth is largely due to the growth in *MERALCO*'s customer base, low inflation and strong consumer confidence, partly offset by lower temperatures. Inflation as at June 30, 2017 stood at 2.8% while average temperature was 28.2°C, down from 28.8°C during the same period last year.

Commercial sales volumes were at 8,045 *GWh*, about 4% higher than in 2016, accounting for 40% of the total energy sold. The top three (3) industry drivers remain to be real estate, hotels and restaurants, and the retail trade. The *BPO* and the Philippine Offshore Gaming Operators ("*POGO*") sectors continue to register strong demand, which is also driven by the growth in the development and occupancy of new high-rise residential units across various market segments, supported by sustained overseas remittances, and the liquidity and affordable credit facilities available from the banking industry. Additionally, hotel and restaurants, and the retail trade remain to be significant contributors to energy sales growth, in line with the Government's aim to position Metro Manila as one of the premier entertainment hubs in Asia, and the development of mixed-use business districts within, and of new communities outside, Metro Manila. These commercial growth areas outside Metro Manila include Cavite, Bulacan and Batangas.

Industrial sales volumes grew by 3% to 5,892 *GWh*, year-on-year, accounting for 29% of total *GWh* sales. Growth was led by the basic metals, food and beverage, rubber and plastics, and semiconductor industries. Real estate projects and Public Private Partnership ("*PPP*") infrastructure projects, even ahead of the Government's "Build, Build, Build" initiatives, drove electricity demand from the basic metal sector. Food and beverage, as well as rubber and plastics, saw their demand grow on the back of healthy consumer demand as overseas and *BPO* remittances expanded and inflation remained benign. The semiconductor industry whose electricity demand had been relatively soft in 2016 has shown signs of recovery, driven by the office computing, automotive and electronics sectors.

MERALCO and *CEDC*'s own initiatives to fully serve customers such as (a) early customer prospecting and planning; (b) early energization through faster and better processing, design and facilitation; (c) new customer programs, and (d) a more robust and reliable sub-transmission and distribution system contributed to boosting customer count and energy sales volumes.

The positive impact of these conditions is reflected in the consolidated sales volume of 20,338 *GWh* for the six months ended June 30, 2017, a 3% growth over the comparative period.

Since the start of the *RCOA*, *MPower* and *Vantage* serve an increasing number of contestable customers with a suite of competitive product offerings for the benefit of its customers, which total to 270 customers out of the 665 customers who have switched to contestability. The semiconductor industry continues to occupy the largest share in the contestable space, followed by the food and beverage and the non-metallic industries.

Other Services

Revenues from other services pertain mainly to revenues of subsidiaries, excluding *CEDC*, *MGen* and *Vantage*. Revenues generated from other services decreased to ₱4,464 million for the six months ended June 30, 2017 from ₱4,817 million in the same period last year. The 7% decrease in revenues from other services is the net effect of (i) the delayed award of projects and slow validation of work accomplishments of *MServ* and *MIESCOR*, as project owners held back on proceedings with certain scheduled projects, and also took longer time in confirming work accomplishments; partly offset by (ii) increased bills payment volumes from *Bayad Center* from over 6,700 sites and collection partners supplemented by spot billings volumes of wholly owned subsidiary; and (iii) higher recurring revenues of *Radius* as a result of an expanding customer base and better service reliability following the bandwidth upgrade.

COSTS AND EXPENSES

Consolidated costs and expenses for the six months ended June 30, 2017 amounted to ₱127,543 million, higher by ₱12,704 million compared with ₱114,839 million in 2016. The following table shows the breakdown of consolidated costs and expenses for the six months ended June 30, 2017 and 2016 by business segment:

	Unaudited					
	For the Six Months Ended June 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
			(Amounts in millions)			
Power[9]	₱124,740	98	₱111,695	97	₱13,045	12
Other services	3,644	3	3,926	4	(282)	(7)
Inter-segment transactions	(841)	(1)	(782)	(1)	(59)	8
Total	**₱127,543**	**100**	**₱114,839**	**100**	**₱12,704**	**11**

Power

The details of costs and expenses are summarized in the following table:

	Unaudited					
	For the Six Months Ended June 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
			(Amounts in millions)			
Purchased power	₱107,683	86	₱95,438	85	₱12,245	13
Salaries, wages and employee benefits	5,188	4	5,184	5	4	–
Depreciation and amortization	3,271	3	3,311	3	(40)	(1)
Contracted services	2,872	2	2,379	2	493	21
Others	5,726	5	5,383	5	343	6
Total	**₱124,740**	**100**	**₱111,695**	**100**	**₱13,045**	**12**

Costs and expenses of power segment for the six months ended June 30, 2017 amounted to ₱124,740 million, 12% higher compared with ₱111,695 million in the same period in 2016.

Purchased power accounted for 86% of the total costs and expenses for the six months ended June 30, 2017. *MERALCO* and *CEDC* do not operate their own generation capacity. All of the electricity distributed are contracted through *PSA*s with generators and long-term *PPA* with *IPP*. The remaining balance is purchased from the *WESM*.

The purchased power cost in the first half of 2017 increased by 13% due to (i) higher fuel cost of natural gas-fired power plants during the maintenance shutdown of the Malampaya gas facilities; (ii) extended maintenance outages of certain coal-fired power plants; and (iii) depreciation of Philippine peso versus U.S. dollar. The increase was negated by lower volume purchased from 19,609 *GWh* in 2016 to 19,215 *GWh* to 2017.

The volume of energy purchased under long-term *PPA*s with *IPPs*, namely, *FGPC*, *FGP* and *QPPL*, represents 33% of *MERALCO*'s *NSI*. Purchases from power generators under *PSA*s, and other special programs accounted for 39%, while purchases from *WESM* accounted by 15% of *NSI*. The balance represents the volume of contestable customers within the franchise area.

Contracted services increased by 21% from ₱2,379 million in 2016 to ₱2,872 million in 2017 on account of higher spending for information system/information technology services, cloud subscriptions and consultancy for various system enhancements and customer-centric projects. Customer-related expenses such as collection services and meter reading services also increased due to growth in number of customer accounts.

[9] *Ibid.*

Other expenses consist of business taxes and permits, provision for probable losses and expenses from claims, provision for doubtful accounts, costs of materials, transportation, and other corporate expenses.

Other Services

The costs and expenses of other services business segment for the six months ended June 30, 2017 amounted to ₱3,644 million, 7% lower compared with ₱3,926 million in the same period in 2016.

	Unaudited					
	For the Six Months Ended June 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
			(Amounts in millions)			
Salaries, wages and employee benefits	₱1,370	38	₱1,236	31	₱134	11
Contracted services	768	21	880	23	(112)	(13)
Depreciation and amortization	191	5	155	4	36	23
Others	1,315	36	1,655	42	(340)	(21)
Total	**₱3,644**	**100**	**₱3,926**	**100**	**(₱282)**	**(7)**

The total cost and expenses of other services business segment decreased by ₱282 million or 7% compared with same period last year consistent with the decrease in revenues of *MIESCOR*, *MServ* and *RSIC*. Salaries, wages and employee benefits increased by ₱134 million due to increase in manpower count and project-hired personnel of *MRail*, *Bayad Center*, and *Radius.*

Other expenses, which consisted mainly of materials, transportation and travel, rental and utility expenses, decreased by ₱340 million in 2017 due to lesser project completions of *MServ*.

OTHER INCOME

The following table shows the breakdown of other income, net of expenses, for the six months ended June 30, 2017 and 2016 by business segment:

	Unaudited			
	For the Six Months Ended June 30			
			Increase/Decrease	
	2017	2016	Amount	%
		(Amounts in millions)		
Power[10]	₱1,132	₱911	₱221	24
Other services	(32)	135	(167)	(124)
Total	**₱1,100**	**1,046**	**₱54**	**5**

[10] *Ibid.*

Power

Breakdown of other income (expenses) of power segment is summarized as follows:

	Unaudited			
	For the Six Months Ended June 30			
			Increase/Decrease	
	2017	2016	Amount	%
	(Amounts in millions)			
Interest and other financial income	₱1,061	₱950	₱111	12
Interest and other financial charges	(717)	(592)	(125)	21
Equity in net earnings of associates and joint ventures	269	25	244	976
Foreign exchange gains (losses)	262	49	213	435
Others	257	479	(222)	(46)
Total	**₱1,132**	**₱911**	**₱221**	**24**

Total other income increased to ₱1,132 million for the six months ended June 30, 2017, 24% higher compared with ₱911 million in the same period in 2016. This is the result of (i) higher contribution from associates and joint ventures (ii) higher yields from investments in government securities; and (iii) continuous depreciation of Philippine peso versus U.S. dollar, which resulted in foreign exchange gains. Such increase was partially offset by the increase in interest and other financial charges by ₱125 million as a result of the ₱10 billion notes payable availed in June 2016.

NET INCOME ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The following table shows the breakdown of net income attributable to equity holders of the parent for the six months ended June 30, 2017 and 2016 by business segment:

	Unaudited					
	For the Six Months Ended June 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[11]	₱10,040	96	₱10,113	94	(₱73)	(1)
Other services	528	5	762	7	(234)	(31)
Inter-segment transactions	(67)	(1)	(107)	(1)	40	(37)
Total	**₱10,501**	**100**	**₱10,768**	**100**	**(₱267)**	**(2)**

Net income attributable to equity holders of the parent for the six months ended June 30, 2017 decreased by 2% mainly due to lower contribution from other services segment.

CHANGES IN FINANCIAL POSITION

Utility Plant and Others

Utility plant and others increased by 2% as at June 30, 2017 mainly due to completed construction of new electric distribution-related facilities and upgrade in major rehabilitation of existing electrical facilities, offset by the depreciation and amortization for the period. Net addition amounted to ₱3,156 million.

Investments in Associates and Interests in Joint Ventures

The increase in investments in associates and interests in joint ventures was primarily due to infusion of additional capital to *RP Energy*, AF Payments, Inc. ("*AF Payments*") and *Pure Meridian*, and new equity investment in Powersource First Bulacan Solar, Inc. ("*Powersource*").

[11] *Ibid.*

Deferred Tax Assets

The increase in deferred tax assets was mainly related to tax effect of provisions recognized during the first half of 2017.

Other Noncurrent Assets

The increase in other noncurrent assets is attributable to (i) higher net under-recovery of generation charge in 2017; and (ii) reclassification of ₱4,919 million approved net over-recoveries to trade and other current liabilities account. Such net over-recoveries will be refunded to the customers within the year.

Cash and Cash Equivalents

The decrease in cash and cash equivalents was the result of combined effects of (i) cash generated from operations amounting to ₱14,201 million; (ii) availment of notes payable and interest-bearing loans of ₱1,813 million; (iii) payment for capital expenditures of ₱5,202 million; (iv) payment of notes payable and interest-bearing loans of ₱1,914 million; (v) net proceeds from sale of available-for-sale ("*AFS*") and held-to-maturity ("*HTM*") investments of ₱517 million; and (vi) payment of cash dividends of ₱10,560 million.

Trade and Other Receivables

Trade and other receivables increased due to the higher average customer retail rate in June 2017 compared with the average retail rate in December 2016.

Other Current Assets

The increase in other current assets was due to reclassification of maturing *HTM* investments to current assets.

Retained Earnings

The increase was mainly due to net income for the period, which was offset by the declaration of cash dividends to stockholders amounting to ₱10,482 million.

Provisions

The change in provisions represents the net settlement during the period.

Other Noncurrent Liabilities

Other noncurrent liabilities pertain to estimated liabilities for regulatory and tax matters. Additional obligations were recognized during the period.

Trade and Other Current Liabilities

The increase in trade and other current liabilities was due to higher purchased power payable as a result of increase in *kWh* purchased for the first half of 2017 and reclassification of ₱4,919 million approved net over-recoveries from other noncurrent assets.

LIQUIDITY AND CAPITAL RESOURCES

The following tables show the cash flows for the six months ended June 30, 2018 and 2017 and the capitalization and other selected consolidated financial data as at June 30, 2018 and December 31, 2017:

	Unaudited	
	For the Six Months Ended June 30	
	2018	2017
	(Amounts in millions)	
Cash Flows		
Net cash provided by operating activities	₱21,461	₱14,201
Net cash used in investing activities	(7,560)	(4,331)
Net cash used in financing activities	(9,060)	(10,800)
Net increase (decrease) in cash and cash equivalents	4,841	(930)
Capital Expenditures	6,499	2,671

	June 30, 2018	December 31, 2017
	(Unaudited)	(Audited)
	(Amounts in millions)	
Capitalization		
Interest-bearing long-term financial liabilities		
Current	₱1,838	₱1,884
Noncurrent	24,410	24,786
Notes payable	13,634	13,586
Equity attributable to equity holders of the parent	75,118	73,610
Other Selected Financial Data		
Total assets	323,960	303,355
Utility plant and others	136,980	133,874
Cash and cash equivalents	50,778	45,937

As at June 30, 2018, cash and cash equivalents amounted to ₱50,778 million, ₱4,841 million higher compared with ₱45,937 million as at December 31, 2017. Following are the significant cash flow activities for the six months ended June 30, 2018: (i) cash generated from operations of ₱21,461 million; (ii) proceeds from sale of *AFS* and *HTM* investments of ₱11,294 million; (iii) availment of notes payable of ₱1,423 million, offset by (i) investment in *AFS*, *HTM* and short-term investments of ₱13,823 million; (ii) payment of cash dividends of ₱9,020 million; (iii) capital expenditures of ₱6,499 million; and (iv) payment of notes payable, interest-bearing loans and related interest of ₱2,594 million.

Debt Financing

On December 12, 2013, *MERALCO* issued ₱11.5 billion and ₱7.0 billion of 7-year (puttable in 2018) and 12-year (puttable in 2023) corporate bonds ("*Bonds*"), respectively. The 12-year corporate bonds also include a call option, whereby *MERALCO* may redeem (in whole but not in part) the outstanding bonds beginning on the 7th year from issue date at an early redemption price of 101%. The put and call options are clearly and closely related to the host instruments, thus, were not recognized separately.

The Bonds are listed on and traded in the Philippine Dealing and Exchange Corporation.

The net proceeds from the bond issuance were used to refinance certain loans, which included principal, interest, prepayment penalties and other financing costs.

MERALCO's loan agreements require compliance with debt service coverage of 1.1 times calculated at specific measurement dates. The agreements also contain restrictions with respect to creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

As at June 30, 2018, *MERALCO* is in compliance with all of the covenants of its loan agreements.

Equity Financing

Consistent with the provisions of *PAS* 32, "Financial Instruments: Disclosure and Presentation", *MERALCO*'s preferred shares are presented as debt with the dividends declared recorded as interest expense. Accumulated and unpaid dividends were accrued and classified as accrued interest payable. Coupon rate on such preferred share is fixed at 10%. The preferred shares were issued related to service applications, which required extension or new distribution facilities beyond a specific distance or standard provisions. Beginning April 8, 2005, such requirement was discontinued. Instead, as provided in the "Implementing Guidelines of the Magna Carta for Residential Electricity Consumers", customers were required to advance the costs of extension of lines and installation of additional facilities. All of the outstanding preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. Total unclaimed dividends amounted to ₱250 million as at June 30, 2018 and December 31, 2017. Interest is no longer accrued when the preferred shares have been called.

As at June 30, 2018 and December 31, 2017, *MERALCO*'s capital stock consists of:
(Amounts in millions except par value and number of shares)

Common stock - ₱10 par value	
Authorized - 1,250,000,000 shares	₱12,500
Issued - 1,127,271,117 shares	11,273
Treasury - 172,412 shares	(11)

Treasury shares represent subscribed shares and the related rights of employees who have opted to withdraw from the Employee Stock Purchase Plan *("ESPP")* in accordance with the provisions of the *ESPP* and which *MERALCO* repurchased.

The table below summarizes the cash dividends declared during the six months ended June 30, 2018 and 2017:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
February 26, 2018	March 28, 2018	April 25, 2018	₱8.07	₱9,090
February 27, 2017	March 27, 2017	April 21, 2017	9.30	10,482

On July 30, 2018, the *BOD* of *MERALCO* approved the declaration of cash dividends of ₱5.31 a share to all shareholders of record as at August 29, 2018, payable on September 24, 2018.

The board of directors ("*BOD*")-approved dividend policy of *MERALCO* consists of (i) regular cash dividends equivalent to 50% of consolidated core net income (*"CCNI"*) for the period, and (ii) special dividend determined on a "look-back" basis. Declaration and payment of special dividend are dependent on the availability of unrestricted retained earnings and availability of free cash. The declaration, record and payment dates shall be consistent with the guidelines and regulations of the Philippine Securities and Exchange Commission ("*SEC*").

RISK FACTORS

The major factors affecting *MERALCO*'s financial position and results of operations are:

- Regulated rates and cost recoveries
- Sales volume and Philippine economic conditions
- Electricity supply
- Industry restructuring

Regulated Rates and Cost Recoveries

The most significant determinants of *MERALCO*'s and *CEDC*'s rate structure vis-à-vis operating results are "valuation of regulatory asset base *("RAB")"*, "allowable return" and "permitted cost recoveries". Distribution rates billed by *MERALCO* and *CEDC* are approved by the *ERC* and are set at rates that allow a reasonable rate of return on investments. *MERALCO* and *CEDC*'s rate structure also allows pass-through of certain purchased power costs, *SL* charge up to an annual cap enforced by the *ERC*, taxes, among others.

Performance-Based Regulations ("PBR")

MERALCO is among the Group A entrants to the *PBR*, together with two (2) other private distribution utilities ("*DU*s").

Rate setting under *PBR* is governed by the Rules for Distribution Wheeling Rates ("*RDWR*"). The *PBR* scheme sets tariffs once every Regulatory Period *("RP")* based on the *RAB* of each *DU*, and the required operating and capital expenditures to meet operational performance and service level requirements responsive to the needs for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC*. *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) Regulatory Years ("*RY*s"). A *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. The 4th *RP* for the Group A *DU*s began on July 1, 2015 and shall end on June 30, 2019.

CEDC is among the four (4) Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. A *RY* for *CEDC* begins on October 1 and ends on September 30. The 3rd *RP* for *CEDC* began October 1, 2015 and shall end on September 30, 2019. *CEDC* is to undergo the reset process and is awaiting the release by the *ERC* of the final rules to govern the filing of its 3rd *RP* reset application.

Pass-through of Allowable Costs

The pass-through of allowable costs or costs that do not entail a revision of the rate base and/or rate of return of *MERALCO* is governed by various adjustment mechanisms promulgated by the *ERC*.

In approving *MERALCO*'s unbundled rate in May 2003, the *ERC* prescribed a generation charge that will be adjusted under the Generation Rate Adjustment Mechanism ("*GRAM*"*)*. This has since been superseded by the Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities. The monthly automatic adjustment under the Automatic Generation Rate Adjustment *("AGRA")* mechanism provides timely price signals to consumers. While the *GRAM* only provided for changes in the generation charge, the new mechanism also allows the monthly adjustment of the *SL* charge. Implementation of the guidelines started with the November 2004 billing cycle.

The *ERC*'s approval of *MERALCO*'s *2nd GRAM* filing was questioned before the Supreme Court *("SC")* for failure by *MERALCO* and the *ERC* to comply with Section 4 (e) Rule 3 of the Electric Power Industry Reform Act *("EPIRA")* Implementing Rules and Regulations *("IRR")* which required publication, notice, and hearing of an application prior to issuance of an Order. On August 16, 2006, the *SC* ruled with finality that strict compliance with the requirements under the *IRR* of the *EPIRA* is jurisdictional and applies to any adjustment to the retail rate, including those for pass-through costs. Beginning September 2006, the *AGRA* was suspended and *MERALCO* could adjust generation and other pass-through charges only after the filing and approval by the *ERC* of an appropriate application.

On June 7, 2007, the Joint Congressional Power Commission approved amendments to Section 4 (e), Rule 3 of the *EPIRA*'s *IRR* that exempt the adjustments of pass-through electric rate components from the jurisdictional and hearing requirements of the *IRR*. The amendments were subsequently promulgated by the Department of Energy *("DOE*") on June 21, 2007. Thereafter, the *ERC* lifted the suspension of the *AGRA*, which allowed *MERALCO* to resume the monthly updating of generation and *SL* charges beginning July 2007.

On July 13, 2009, the *ERC* issued its Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities." These rules govern the recovery of pass-through costs, including over- or under-recoveries in the following bill components: generation charge, transmission charge, *SL* charge, lifeline and inter-class rate subsidies, local franchise tax *("LFT*") and business tax.

The rules will also synchronize the various confirmation processes for the foregoing charges, in which the *ERC* will verify whether the *DU* incurred over- or under-recoveries in the implementation of the said charges. Luzon *DU*s, such as *MERALCO*, were required to file not later than October 30, 2009, their consolidated applications to resolve over- or under-recoveries accumulated from the start of their rate unbundling until December 2008. Subsequent filings will be every three (3) years thereafter.

On October 8, 2009, *MERALCO* filed a petition at the *ERC* seeking an amendment to *ERC*'s Resolution No. 16, Series of 2009. In particular, *MERALCO* proposed a modification to the formula used in confirming the *SL* charges of *DU*s, shifting the reckoning of the *SL* cap from monthly to annual, which fairly reflects the actual *SL* performance of *DU*s.

On October 18, 2010, the *ERC* ruled on *MERALCO*'s Petition and agreed that there is a need to address the mismatch between the billing periods of the *DU*s and of their suppliers in the confirmation of the *SL*. However, the *ERC* did not adopt *MERALCO*'s proposed modification to the formula and instead prescribed a new formula. *ERC* Resolution No. 21, Series of 2010 adopted the new formula and correspondingly amended a prescribed in Resolution No. 16, Series of 2009. The Resolution also prescribed the period of filing for a *DU*'s consolidated applications, which for Luzon *DU*s shall be by March 31, 2011. Further, March 31, 2011 (covering adjustments implemented from the rate unbundling until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) were set as the new deadlines for *DU*s in Luzon to file their respective applications. Subsequent filings shall likewise be every three (3) years thereafter.

Revised SL Caps

On December 8, 2008, the *ERC* promulgated resolution No.17, Series of 2008 adopting a lower maximum rate of *SL* (technical and non-technical) that a utility can pass on to its customers. The revised *SL* cap is 8.5% for private utilities, starting their January 2010 billing. The said cap is one (1) percentage point lower than the *SL* cap of 9.5% provided under *RA* No. 7832. The actual volume of electricity used by *MERALCO* (administrative loss) is treated as part of the operation and maintenance expense beginning July 2011. The manner by which the utility is rewarded for its efforts in *SL* reduction is addressed by the *ERC* in the Performance Incentive Scheme ("*PIS*") under the *PBR*.

On October 4, 2016, a legislator proposed a bill to lower the current cap of *SL* rate from 8.5% to 5% for private *DU*s and from 13% to 10% for electric cooperatives and to exclude non-technical system losses and electricity used by the private *DU*s and electrical cooperatives from what may be passed on to consumers as *SL* charges. As at July 30, 2018, this proposed bill is still subject for deliberation of the Senate.

On May 9, 2017, the *ERC* posted on its website the draft rules on the Proposed Rules for Setting the Distribution System Loss Cap and Establishing Performance Incentive Scheme for Distribution Efficiency. The *ERC* engaged a third party consultant to conduct the study on the *SL* of *DU*s and propose new caps. Said rules proposed different *SL* caps according to four (4) clusters. Electric cooperatives ("*EC*") were grouped in clusters 1 to 3 and private *DU*s in cluster 4. *DU*s in clusters 1 to 4 have proposed system loss caps of 11.5%, 10%, 7.75%, and 4%, respectively. These caps, which include feeder technical loss and nontechnical loss but exclude sub- transmission and substation technical losses are proposed to be implemented based on the *DU*'s next regulatory reset schedule. For *MERALCO*, the proposed implementation date is July 2019. A series of public consultations and focus group discussions followed, the latest of which was a public consultation for Mindanao stakeholders held in Pasig City on August 9, 2017. In said public consultation, the third party consultant proposed a graduated reduction in system loss caps per cluster. Beginning 2018, *DU*s in clusters 1 to 3 shall have a cap of 12% and *DU*s in cluster 4 shall have a cap of 8%, all of which exclude subtransmission and substation system losses. The caps of cluster 1 to 3 will remain/be lowered to 12%, 10.25%, 8.25% by 2022, respectively. For private *DU*s, the cap will be reviewed based on their submission of annual feeder data to the *ERC*. If private *DU*s fail to submit one (1) year's data (from 2018-2020), its cap in 2022, shall be set

at 4.75% excluding subtransmission and substation system losses. The latest proposal of the third party consultant also includes a 1% cap on subtransmission and substation system losses which was not previously capped in the original draft rules.

On February 23, 2018, the *ERC* posted in its website its Rules for Setting the Distribution System Loss ("*DSL*") Cap and Establishing Performance Incentive Scheme for Distribution Efficiency.

The Rules allow for a gradual reduction of Feeder System (Primary and Secondary Distribution System) Loss caps as follows:

Year of Implementation	*EC* Cluster 1	*EC* Cluster 2	*EC* Cluster 3	Cluster 4 (Private *DU*s)
		(in percentage)		
2018	12.00	12.00	12.00	6.50
2019	12.00	11.00	11.00	6.25
2020	12.00	10.25	10.00	6.00
2021	12.00	10.25	9.00	5.50
2022 and onwards	12.00	10.25	8.25	4.75*

*if no annual submission of feeder data

On May 7, 2018, the *ERC* posted on its website Resolution No. 10, Series of 2018, or "A Resolution Clarifiying the System Loss Calculation and Providing the Effectivity of the Rules for Setting the Distribution System Loss Cap". The Resolution was issued in response to the request for clarification of *EC*s on certain issues regarding the Rules for Setting the *DSL* Cap and Establishing Performance Incentive Scheme for Distribution Efficiency. The Rules for Setting the *DSL* Cap and Establishing Performance Incentive Scheme for Distribution Efficiency was published on the same day. Accordingly, the prescribed system loss cap shall be effective on the next billing cycle of the *DU*s customers.

Subtransmission and substation loss is fully recoverable. However, if *DU*s do not submit monthly metered subtransmission and substation distribution loss data, such losses, as well as distribution feeder losses, will be set to zero in the computation of the recoverable system loss charge. The *DU* may also elect for an individualized *DSL* cap.

Sales Volume and Philippine Economic Conditions

The sale of electricity is driven mainly by prevailing economic conditions and the number of customers being served by *MERALCO*. The output from *MERALCO*'s franchise area accounts for more than 50% of the Philippines' *GDP*, with 37% of the total sales generated in Metro Manila.

For the six months ended June 30, 2018, *MERALCO* and *CEDC*'s combined energy sales volume was 21,665 *GWh*, 7% higher compared with 20,338 *GWh* in 2017. The growth is from the expansion in *MERALCO*'s customer base and strong consumer spending spurred by inward remittances from overseas Filipinos and the continuing growth of the *BPO* and *POGO*.

Electricity Supply

All of the electricity distributed by *MERALCO* and *CEDC* are contracted through *PSA*s with generators and long-term *PPA* with *IPP*. The remaining balance is purchased from the *WESM*. *WESM* is a venue where suppliers and buyers trade electricity as a commodity.

IPPs

MERALCO

First Gas Power Corporation ("FGPC") and FGP

In compliance with the *DOE's* program to create a market for Camago-Malampaya gas field and enable its development, *MERALCO* has committed to contract 1,500 *MW* of the 2,700 *MW* output of the Malampaya gas field.

Accordingly, *MERALCO* entered into separate 25-year *PPA*s with *FGPC* (March 14, 1995) and *FGP* (July 22, 1999) for a minimum number of *kWh* of the net electrical output of the Sta. Rita and San Lorenzo power plants, respectively, from the start of their commercial operations. The *PPA* with *FGPC* terminates on August 17, 2025, while that of *FGP* ends on October 1, 2027.

On January 7, 2004, *MERALCO*, *FGP* and *FGPC* signed an Amendment to their respective *PPA*s. The negotiations resulted in certain new conditions including the assumption of *FGP* and *FGPC* of community taxes at current tax rate, and subject to certain conditions increasing the discounts on excess generation, payment of higher penalties for non-performance up to a capped amount, recovery of accumulated deemed delivered energy until 2011 resulting in the non-charging of *MERALCO* of excess generation charge for such energy delivered beyond the contracted amount but within a 90% capacity quota. The amended terms under the respective *PPA*s of *FGP* and *FGPC* were approved by the *ERC* on May 31, 2006.

Under the respective *PPA*s of *FGP* and *FGPC*, the fixed capacity fees and fixed operating and maintenance fees are recognized monthly based on the actual Net Dependable Capacity tested and proven, which is usually conducted on a semi-annual basis.

QPPL

MERALCO entered into a *PPA* with *QPPL* on August 12, 1994, which was subsequently amended on December 1, 1996. Under the terms of the amended *PPA*, *MERALCO* is committed to purchase a specified volume of electric power and energy from *QPPL*, subject to certain terms and conditions. The *PPA* is for a period of 25 years from the start of commercial operations up to July 12, 2025.

In a Letter Agreement signed on February 21, 2008, the amount billable by *QPPL* included a transmission line charge reduction in lieu of a previous rebate program. The Letter Agreement also provides that *MERALCO* make advances to *QPPL* of US$2.85 million per annum for 10 years beginning 2008 to assist *QPPL* in consideration of the difference between the transmission line charge specified in the Transmission Line Agreement ("*TLA*") and the *ERC*-approved transmission line charge in March 2003. *QPPL* shall repay *MERALCO* the same amount at the end of the 10-year period in equal annual payments without adjustment. However, if *MERALCO* is able to dispatch *QPPL* at a plant capacity factor of no less than 86% in any particular year, *MERALCO* shall not be required to pay US$2.85 million on that year. This arrangement did not have any impact on the rates to be charged to consumers and hence, did not require any amendment in the *PPA*, as approved by the *ERC*.

Committed Energy Volume to be Purchased

The following are forecasted purchases/payments to *FGPC*, *FGP* and *QPPL* corresponding to the Minimum Energy Quantity ("*MEQ*") provisions of the contracts. The forecasted fixed payments include capacity charge and fixed operation and maintenance cost escalated using the U.S. and Philippine Consumer Price Index.

Year	MEQ	Equivalent Amount
	(In million kwh)	*(In Millions)*
2018	14,717	₱23,502
2019	14,898	23,495
2020	14,898	24,040
2021 to 2025	74,488	118,938
2026 to 2027	21,797	37,431

Power Supply Generators Under PSAs

The table below summarizes the salient features of the signed *PSA*s/Contract to Sell of Electricity ("*CSE")* with power supply generators, some of which are still pending approval by the *ERC*:

Date	**Power Supplier**	**Plant/Contracted Capacity**	**Terms of *PSA/CSE***
October 6, 2017	Solar Philippines Tarlac Corporation ("*Solar Philippines Tarlac*")	Solar power plant for contracted capacity of 85 *MW*	Term of 20 years
September 16, 2016	*First Bulacan*	Solar power plant for contracted capacity of 50 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
September 16, 2016	Solar Philippine Tanauan Corporation ("*Solar Philippines Tanauan*")	Solar power plant for contracted capacity of 50 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 27, 2016	Global Luzon Energy Development Corporation ("*GLEDC*")	Coal-fired power plant for contracted capacity of 600 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	*A1E*	Supercritical coal-fired power plant for contracted capacity of 2 x 600 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	Central Luzon Premiere Power Corporation ("*Central Luzon Power*")	*CFB* coal-fired power generating facility for contracted capacity of 4 x150 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.

Date	Power Supplier	Plant/Contracted Capacity	Terms of *PSA/CSE*
April 26, 2016	*Mariveles Power*	*CFB* coal-fired power generating facility for contracted capacity of 528 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	Panay Energy Development Corporation ("*PEDC*")	Coal-fired power generating facility for contracted capacity of 70 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	*St. Raphael*	Coal-fired power plant for contracted capacity of 400 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 20, 2016	*RP Energy*	Coal-fired power plant for contracted capacity of 225 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
November 25, 2014	Bacman Geothermal, Inc. *("BGI")*	Geothermal power plants for contracted capacity of 50 *MW*	Term of five (5) years pending approval extendable for another two (2) years upon mutual agreement of the parties.
May 30, 2014	*SBPL*	Supercritical coal-fired power plant for 455 *MW* (net) capacity and electrical output	Term of 20 years, extendible for another five (5) years at the option of *MERALCO*.
May 15, 2014	Philippine Power and Development Corporation *("Philpodeco")*	1 *MW* hydro power plants	Term of five (5) years which may be extended upon mutual agreement of parties.
September 27, 2013	Therma Mobile, Inc. *("TMO")*	Output of the barged-mounted, bunker oil-fired diesel engines moored at the Fishport Complex in Navotas, Manila.	Term expired on June 25, 2017, which may be extended upon mutual agreement of parties.
June 26, 2012	San Miguel Energy Corporation *("SMEC")*	Sual coal-fired power plant with initial contracted capacity of 200 *MW* to increase to 500 *MW* by December 26, 2012	Term of seven (7) years, which may be extended up to five (5) years upon agreement of parties.
May 31, 2012	Pangea Green Energy Philippines, Inc. *("PGEP")*	Biogas power plant methane gas with a total nominal generating capacity of 1 *MW*.	Term of two (2) years from the delivery period commencement date, unless amended by the parties. On March 2, 2015, *MERALCO* and *PGEP* executed a Letter

Date	Power Supplier	Plant/Contracted Capacity	Terms of *PSA/CSE*
			of Agreement extending the *CSE* until February 29, 2016.
February 29, 2012	Therma Luzon, Inc. *("TLI")*	Pagbilao coal-fired power plant with contracted capacity of 350 *MW* located in Quezon Province	Term of seven (7) years, which may be extended for three (3) years upon agreement of parties.
December 21, 2011	Masinloc Power Partners Co., Ltd. *("MPPCL")*	The initial contracted capacity is 330 *MW*, to increase to 430 *MW* by December 26, 2015	The *PSA* is for a period of seven (7) years and can be extended by the parties for another three (3) years. Under the agreement, the terms of the *NPC-MERALCO TSC* will govern the supply by *MPPCL* to *MERALCO*.
December 20, 2011	*Sem-Calaca*	The initial contracted capacity is 210 *MW* and will be increased to 420 *MW* upon the commercial operation of the plant's Unit 1.	Term of seven (7) years, which may be extended by the parties for another three (3) years.
December 12, 2011	South Premiere Power Corporation *("SPPC")*	Ilijan Power Plant in Batangas, for the full 1,180 *MW* net capacities	Under the *PSA*, *MERALCO* shall procure power from *SPPC* until December 25, 2019, with an option to extend the term for another three (3) years.
November 12, 2010	Bacavalley Energy, Inc. *("BEI")*	4 *MW* renewable energy generation facility powered by landfill gas in San Pedro, Laguna.	Term of two (2) years from the delivery period commencement date. On March 12, 2015, *MERALCO* and *BEI* executed a letter of Agreement extending the *CSE* until March 16, 2016. On March 1, 2016, *BEI* requested for another extension of the *CSE* for another two (2) years. In its letter dated April 7, 2016, *MERALCO* denied *BEI*'s request to extend the *CSE*.

PSAs with Privatized Plants and IPPAs

In a separate Decisions dated December 17, 2012, the *ERC* approved with modifications, the *PSA*s of *MERALCO* with *SPPC*, *Sem-Calaca*, *MPPCL*, *TLI* and *SMEC*.

Motions for Reconsideration (*"MR"*) were filed regarding the *ERC* decisions on the *PSA*s with *SPPC*, *Sem-Calaca* and *SMEC*. *MERALCO* is awaiting the decision of the *ERC* on the *SPPC* and *Sem-Calaca MR*s. In an Order dated December 16, 2013, the *ERC* denied the Motion for Partial Reconsideration on the *PSA* with *SMEC*. Both *MERALCO* and *SMEC* have filed separation motions with respect to such order. In an Order dated May 29, 2018, the *ERC* partially granted the Motion for Partial Reconsideration on the *PSA* with *Sem-Calaca*. On July 25, 2018, *MERALCO* filed a motion for clarification of the said Order and the parties are under discussions regarding how to implement the same.

MERALCO entered into separate Supplemental Agreements with *MPPCL* and *TLI* on April 8 and 27, 2016, respectively, for the extension of the term of these *PSA*s for an additional period of three (3) years up to December 25, 2022. Thereafter, relevant Manifestations with Motion for Approval of the Supplemental Agreements were filed with the *ERC*.

Under the *PSA*s approved by the *ERC*, fixed capacity fees and fixed operating maintenance fees are recognized monthly based on their contracted capacities. The annual projections for these payments are shown in the table below:

Year	Contracted Capacity	Fixed Payment Amount
	(In Megawatt)	*(In millions)*
2018	2,425	₱31,663
2019	2,430	28,100
2020	1,035	19,030
2021	525	9,300
2022-2036	525	144,850
2037-2039	455	26,875

On January 1, 2018, the *Tax Reform for Acceleration and Inclusion* ("*TRAIN*") Law became effective. Among other things, the *TRAIN* Law increased the excise tax on coal from ₱10.00 per metric ton to ₱50.00 per metric ton, effective January 1, 2018. This tax is to increase year on year, up to ₱150.00 per metric ton for coal, effective January 1, 2020. Under *MERALCO*'s *PSA* with *TLI*, should there be any increase in existing charges, fees, taxes, duties assessments, or other similar amounts, a party to the *PSA* may claim the same as a charge due to change in law, upon *ERC* approval thereof. On July 19, 2018, *MERALCO* and *TLI* filed a joint application for approval of recovery of the increase in excise tax as a result of the implementation of the *TRAIN* Law.

PGEP

On May 31, 2012, *MERALCO* signed a *CSE* with *PGEP*, a biomass power plant located in Payatas, Quezon City using methane gas extracted from the Payatas Landfill as its fuel. Its plant has a total nominal generating capacity of 1,236 *kW*. The *CSE* is for a period of two (2) years from the delivery period commencement date.

On June 15, 2012, *MERALCO* filed an application for approval of the *CSE*. On August 28, 2012, the *ERC* issued an Order provisionally approving the application. On August 29, 2013, the *ERC* extended the provisional authority in its Order dated August 12, 2013. On March 2, 2015, *MERALCO* and *PGEP* executed a Letter of Agreement extending the *CSE* until February 29, 2016. On March 4, 2015, *MERALCO* filed a Manifestation with Motion with the *ERC* for approval of the extended term. On September 16, 2015, *MERALCO* received a letter from *PGEP* seeking the termination of the *CSE* effective October 15, 2015. The termination of the *CSE* was thereafter formalized in the Letter Agreement dated October 29, 2015 where the parties agreed to terminate the *CSE* effective October 9, 2015, which was *PGEP*'s Facility Registration Date with the *WESM*. On January 8, 2016, *MERALCO* filed a Manifestation with Motion with the *ERC* seeking approval of the extended term of March 4, 2015 until October 9, 2015. As at July 30, 2018, the contract term has expired and the decision remains pending with the *ERC*.

TMO

On March 4, 2013, *MERALCO* signed an Interconnection Agreement with *TMO* for their 243 *MW* generating facility at the Navotas Fish Port Complex, Navotas City, which is an interconnection at *MERALCO*'s Grace Park-Malabon 115 *kV* line, *TMO* is an embedded generator. *TMO* shall construct at its own cost, operate and maintain the 115 *kV* line connecting its generating facility to *MERALCO*'s system. *TMO* and *MERALCO* subsequently signed a Supplement to the Interconnection Agreement dated July 3, 2014 covering the construction of a second line from the connection point at the Grace Park-Malabon 115 *kV* line to the *TMO* switchyard.

On September 27, 2013, *MERALCO* signed a *PSA* with *TMO* for the output of the barge-mounted, bunker oil-fired diesel engines moored at the Fish port Complex in Navotas, Manila. On September 30, 2013, *MERALCO* filed an application with the *ERC* for the approval of the *PSA*. In an Order dated November 4, 2013, the *ERC* granted the prayer for Provisional Authority. After hearing and submission of the required documents, including the Formal Offer of Evidence *("FOE")*, the case is now submitted for decision.

On December 17, 2014, *MERALCO* and *TMO* entered into an Amendment to the *PSA* based on the power situation outlook for 2015 and 2016 issued by the *NGCP* that the reserve capacity will be below the Contingency Reserves due to the maintenance shutdowns and forced outages of major power plants in Luzon. The amendment to the *PSA* was filed for approval with the *ERC* on January 21, 2015. In an Order dated April 6, 2015, the *ERC* approved the Amendment in the *PSA* between *MERALCO* and *TMO* with modification. In an Order dated July 1, 2015, the *ERC* clarified that the provisional approval, while not specifically modifying nor stating any condition with respect to the implementation of the outage provisions of the amendment, covers the increase in outage allowance and the minor change in operating procedures.

On June 16, 2015, *MERALCO* received the Omnibus Motion for Partial Reconsideration and Deferment of Implementation of the Order dated April 6, 2015; Urgent Resolution of the Application; and Confidential Treatment filed by *TMO*.

In an Order dated April 5, 2016, the *ERC* ruled that the provisional authority granted to *MERALCO* and *TMO* is extended unless revoked or made permanent. On June 10, 2016 and July 5, 2016, respectively, *MERALCO* and *TMO* filed a Motion for Clarification of the *ERC* Order dated April 5, 2016. Said motions are still pending decision by the *ERC*. On January 3, 2017, *MERALCO* filed a Manifestation with Motion informing the *ERC* of the extension of the term of the *PSA* from June 26, 2017 to June 25, 2018. In an Order dated June 6, 2017, the *ERC* noted *MERALCO*'s Manifestation and Motion and confirmed the one (1) year extension of the *PSA*. *MERALCO* and *TMO* were further directed to strictly comply with the provisions of *ERC* Resolution No. 1, Series of 2016, in particular, the one (1) time limit for renewal of the *PSA*. In a letter dated June 11, 2018, *MERALCO* wrote to *DOE*, requesting for grant of exemption from conduct of a competitive selection process, as required under *DOE* Circular No. DC2018-02-003, for a *PSA* with *TMO* with term from June 26, 2018 to June 25, 2019. *TMO* sent a similar letter subsequently. Parties still await action of *DOE* on such request. As at July 30, 2018, the contract term has expired and the decision remains pending with the *ERC*.

Philpodeco

On May 15, 2014, *MERALCO* and *Philpodeco* executed a *PSA*. *Philpodeco* operates three (3) run-of-river hydro power plants, namely: (i) Palakpakin, a 448 *kW* hydro power plant located at Barangay Prinza, Calauan, Laguna; (ii) Calibato, a 75 *kW* Calibato hydro power plant located at Barangay Sto. Angel, San Pablo City, Laguna; and (iii) Balugbog, a 528 *kW* hydro power plant located at Barangay Palina, Nagcarlan, Laguna. The *PSA* has a term of five (5) years from the delivery period commencement date.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for the approval of its *PSA* with *Philpodeco*. This *PSA* provides that *MERALCO* shall accept all the energy deliveries of *Philpodeco* as measured by the latter's billing meter. Hearings on this case have been completed and *MERALCO* has submitted its *FOE*. As at July 30, 2018, the case is pending decision by the *ERC*.

SBPL

On May 30, 2014, *MERALCO* signed a long-term *PSA* for a 455 *MW* net capacity and electrical output with *SBPL*. *SBPL* will be constructing a supercritical coal-fired power plant in Mauban, Quezon.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for approval of its *PSA* with *SBPL*. On May 19, 2015, *MERALCO* received the *ERC* Decision approving with modification the *PSA* between *MERALCO* and *SBPL*.

BGI

On November 25, 2014, *MERALCO* signed a *PSA* with *BGI* for the purchase of up to 50 *MW* capacity and energy from the latter's power plant. The *PSA* shall expire on December 25, 2019, extendible by an additional two (2) years upon mutual agreement of the parties. On March 4, 2015, the Joint Application for approval of said *PSA* was filed with the *ERC*. As at July 30, 2018, the case is pending decision by the *ERC*.

RP Energy

On April 20, 2016, *MERALCO* signed a 20-year *PSA* with *RP Energy* for the purchase of 225 *MW* capacity and energy from the first 300 *MW* unit of 2 x 300 *MW* coal-fired power plant that *RP Energy* intends to construct, own, operate, manage and maintain in Subic, Zambales, within the Subic Bay Freeport Zone. On April 29, 2016, the Joint Application for approval of the said *PSA* was filed with the *ERC*. After hearings and filing by *MERALCO* and *RP Energy* of their respective *FOE*, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s which the *ERC* likewise denied in an order dated November 17, 2017. On January 5, 2018, the *ERC* conducted a hearing for the purpose of giving the consumer group a chance to present its evidence. However, due to its unjustified and continued absence, the consumer group was deemed to have waived its right to present its evidence. Thus, the *ERC* deemed the case submitted for decision. However, despite the case having been submitted for decision, the *ERC* hearing officer allowed an oppositor to submit his written comment/opposition to the continuation of the proceedings. On January 15, 2018, a written comment/opposition was filed by oppositor and on January 19, 2018, *MERALCO* filed its opposition to the said comment/opposition. As at July 30, 2018, the case is pending decision by the *ERC*.

A1E

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *A1E* for the purchase of 1,200 *MW* of electrical output from the 2 x 600 *MW* supercritical coal-fired power generating facility that *A1E* intends to construct, own, operate, manage and maintain in Atimonan, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. After completion of the hearings and filing by *MERALCO* and *A1E* of their respective *FOE* on March 8, 2017, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s, which the *ERC* likewise denied in an order dated November 17, 2017. On March 29, 2017, *MERALCO* and *A1E* filed their Joint Urgent Motion to Resolve. On May 22, 2017, *A1E* filed its Manifestation for Urgent Resolution. Thereafter, on May 23, 2017, *MERALCO* and *A1E* both filed separate letters for urgent resolution of the case. On October 19, 2017, *MERALCO* filed its Third Urgent Motion to Resolve. Then on November 8, 2017, *MERALCO* received *A1E's* Urgent Motion for Resolution. As at July 30, 2018, the case is pending decision by the *ERC*.

St. Raphael

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *St. Raphael* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *St. Raphael* intends to construct, own, operate, manage and maintain in Calaca, Batangas. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. After hearings and filing by *MERALCO* and *St. Raphael* of their respective *FOE*, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated

opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s, which the *ERC* likewise denied in an order dated November 17, 2017. On January 10, 2018, the *ERC* conducted a hearing for the purpose of giving the consumer group a chance to present its evidence. However, due to its unjustified and continued absence, the consumer group was deemed to have waived its right to present its evidence. Thus, the *ERC* deemed the case submitted for decision. Nevertheless, on April 13, 2018, the *ERC* issued an Order directing *MERALCO* and *St. Raphael* to submit additional compliance documents (all to be provided by *St. Raphael*) in order to aid *ERC* in its evaluation of the present case.

Central Luzon Power

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Central Luzon Power* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *Central Luzon Power* intends to construct, own and operate in Pagbilao, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated January 25, 2017, the *ERC* held the processing of the application in abeyance. On March 2, 2017, *MERALCO* received the *MR* of *Central Luzon Power* on of the said *ERC* Order. Meanwhile, several consumers filed their petitions to intervene. On July 25, 2017, *MERALCO* received a copy of a Motion filed by several consumers with the *ERC* on July 14, 2017 seeking the dismissal of the case, to which *MERALCO* filed an Opposition. In an Order dated March 20, 2018, *ERC* directed *MERALCO* and *Cental Luzon Power* to submit a written explanation on the status of the *ECC* application, or in the alternative, should the *ECC* be ready, to submit the same to the *ERC*. *Central Luzon Power* filed a pleading explaining status of the *ECC* application. As at July 30, 2018, further *ERC* action is pending.

Mariveles Power

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Mariveles Power* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *Mariveles Power* intends to construct, own and operate in Mariveles, Bataan. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On September 30, 2016, *Mariveles Power* filed a *MR* of the said *ERC* Order. Meanwhile, several consumers filed their petitions to intervene. On July 25, 2017, *MERALCO* received a copy of a Motion filed by several consumers with the *ERC* on July 14, 2017 seeking the dismissal of the case, to which *MERALCO* filed an Opposition. In an Order dated March 20, 2018, *ERC* directed *MERALCO* and *Mariveles Power* to submit a written explanation on the status of the *ECC* application, or in the alternative, should the *ECC* be ready, to submit the same to the *ERC*. *Mariveles Power* filed a pleading explaining status of the *ECC* application. As at July 30, 2018, further *ERC* action is pending.

PEDC

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *PEDC* for the purchase of up to 70 *MW* of electrical output from the 1 x 150 *MW* coal-fired power generating facility that *PEDC* owns and operates in Brgy. Ingore, La Paz, Iloilo. In its letter dated November 23, 2016, the *ERC* informed *MERALCO* that *ERC* has provisionally approved the *PSA* between *MERALCO* and *PEDC* in its order dated July 11, 2016. On January 10, 2017, *MERALCO* and *PEDC* filed their Joint Motion to Admit the *FOE* with Joint Urgent Motion for Early Resolution of the Application, seeking to, among other things, already source 70 *MW* from *PEDC* beginning January 28, 2017 in order to temper the anticipated additional burden that the *SPEX*-Malampaya outage may bring to end-users. On January 17, 2017, *MERALCO* received a letter dated November 23, 2016, informing *MERALCO* that *ERC* provisionally approved the *PSA*. On March 3, 2017, *PEDC* filed a Motion partially seeking reconsideration of the provisional rate approved under the *PSA*. On October 3, 2017, *PEDC* filed a Supplemental Motion for Reconsideration. On April 30, 2018, *MERALCO* received *PEDC*'s Manifestation and Motion praying that *MERALCO* be authorized by the *ERC* to collect from its customers the difference between the provisional rate approved by the *ERC* and the rates originally applied for under the *PSA*. As at July 30, 2018, further *ERC* action is pending.

Meanwhile, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s, which the

ERC likewise denied in an order dated November 17, 2017. On January 15, 2018, the *ERC* conducted a hearing for the purpose of giving intervenor *NASECORE* a chance to present its evidence. However, due to its unjustified and continued absence, *NASECORE* was deemed to have waived its right to present its evidence. Thus, the *ERC* deemed the case submitted for decision. On January 19, 2018, *MERALCO* received a motion filed by an oppositor before the *CA* seeking additional time to file a Petition for Review. On January 26, 2018, *MERALCO* received the Petition for Review. In a decision dated February 28, 2018, the *CA* denied the Petition, prompting the oppositor's filing of an *MR*. As at July 30, 2018, the *CA* has yet to act on the *MR*.

GLEDC

On April 27, 2016, *MERALCO* signed a 20-year *PSA* with *GLEDC* for the purchase of 600 *MW* of electrical output from the 2 x 335 *MW* coal-fired power generating facility that *GLEDC* intends to construct, own, operate, manage and maintain in Luna, La Union. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On October 21, 2016, *MERALCO* received *GLEDC*'s *MR* of the said Order. Meanwhile, several consumers filed their petitions to intervene. On July 25, 2017, *MERALCO* received a motion seeking the dismissal of the case, to which *MERALCO* filed an Opposition. On March 6, 2018, *GLEDC* filed a Manifestation updating the *ERC* of the status of its *ECC* Application. In an Order dated March 20, 2018, *ERC* directed *MERALCO* and *GLEDC* to submit a written explanation on the status of the *ECC* application, or in the alternative, should the *ECC* be ready, to submit the same to the *ERC*. *GLEDC* filed a pleading explaining status of the *ECC* application. As at July 30, 2018, the case is still awaiting further action from the *ERC*.

First Bulacan

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *First Bulacan* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan. On February 23, 2017, after conduct of a Competitive Selection Process ("*CSP*") wherein *First Bulacan* was declared as the winning power supplier, the application for approval of the *PSA* with *First Bulacan* was filed. Hearings have been completed and *MERALCO* filed its *FOE* on July 12, 2017. In a letter dated December 29, 2017, the *ERC* informed *MERALCO* and *First Bulacan* that the *ERC* resolved to grant interim relief for approval of the *PSA*. However, such interim relief is not contemplated under the *PSA* and the parties have yet to implement the *PSA*. *First Bulacan* filed a Motion for Reconsideration and an Urgent Motion to Resolve the Motion for Reconsideration, which sought reconsideration of the Order of interim relief. As at July 30, 2018, both are pending resolution by the *ERC*.

Solar Philippines Tanauan

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tanauan* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas. On February 27, 2017, after conduct of a *CSP* wherein *Solar Philippines Tanauan* was declared as the winning power supplier, the application for approval of the *PSA* with *Solar Philippines Tanauan* was filed. Hearings have been completed and *MERALCO* filed its *FOE* on July 12, 2017. In a letter dated December 29, 2017, *ERC* informed *MERALCO* and *Solar Philippines Tanauan* that the *ERC* resolved to grant an interim relief for approval of the *PSA*. However, such interim relief is not contemplated under the *PSA* and the parties have yet to implement the *PSA*.

Solar Philippines Tarlac

On October 6, 2017, after being declared the winner power supplier in a *CSP*, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tarlac* for the purchase of up to 85 *MW* of electrical output from its solar plant in Tarlac. The application for approval of the *PSA* with *Solar Philippines Tarlac* was filed on October 19, 2017. Hearings have been completed and parties await *ERC* resolution on *Solar Philippines Tarlac*'s opposition to a consumer group's intervention, which shall prompt submission of case for final decision. Meanwhile, in an Order dated February 20, 2018, the *ERC* granted Interim Relief to provisionally implement the *PSA*. On July 3, 2018, *Solar Philippines Tarlac* filed a Motion for Partial Reconsideration of the Order dated February 20, 2018 of the *ERC*. *MERALCO* and *Solar Philippines Tarlac* have on-going discussions to resolve implementation of the Order.

First NatGas Power Corp. ("FNPC")

Following conduct and completion of a *CSP*, *MERALCO* confirmed effectivity of the *PSA* with *FNPC* dated December 13, 2017, for the purchase of electric energy generated by its Plant beginning *ERC* approval and ending on February 23, 2024. A joint application for approval of the *PSA* with *FNPC* was filed on March 19, 2018. In an Order dated June 5, 2018, *ERC* granted Interim Relief to provisionally implement the *PSA*. On June 26, 2018, *MERALCO* and *FNPC* implemented the *PSA* based on the June 5, 2018 Order of the *ERC*. Hearings have commenced and the next one is set on August 6, 2018.

Interim Power Supply Agreement ("IPSA")

On January 19, 2016, after the conduct of a price challenge in compliance with *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed an *IPSA* with 1590 Energy Corporation. The *IPSA* is for the 170 *MW* (firm from February 26 to July 25, 2016; non-firm from July 26, 2016 to February 25, 2017) output from the Bauang power plant – a 215 *MW* bunker oil-fired diesel engine power plant in Bauang, La Union. The term of the *IPSA* is until February 25, 2017, and shall be automatically extended for an additional period of one (1) year up to two (2) times, unless terminated by either party prior to the expiration of its term. The *IPSA* was filed for approval by the *ERC* on February 10, 2016 and shall become effective upon the approval by the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved the *IPSA*. Pursuant to provisions of the *IPSA*, in a letter dated November 10, 2017, *MERALCO* informed 1590 Energy Corporation that it is no longer interested in renewing the *IPSA*, thus, the *IPSA* will only be until February 25, 2018. As at July 30, 2018, the contract term has expired and *MERALCO* awaits the *ERC*'s final decision on the *IPSA*.

On January 21, 2016, after the conduct of a price challenge in compliance to *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed two (2) separate *IPSA*s with the following wholly owned subsidiaries of *GBPC*, namely; (i) *TPC* for the 28 *MW* (firm) output from its 40 *MW* diesel-fired power plant in Carmen, Toledo City; and (ii) *PPC* for the 45 *MW* (firm) output from its 72 *MW* diesel-fired power plant in La Paz, Iloilo City. The term of the *IPSAs* is until February 25, 2017, and shall be automatically extended for an additional period of one (1) year up to four (4) times, unless terminated by either party prior to the expiration of its term. On February 10, 2016, both *IPSA*s were filed for approval of the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved these *IPSA*s.

On January 26, 2017, considering the imminent Malampaya shutdown from January 28 until February 16, 2017, *MERALCO* agreed to extend the *IPSAs* with *TPC* and *PPC* until February 25, 2018, provided that beginning January 28, 2017, (i) supply from *TPC* and *PPC* will be through replacement energy at a price lower than the contract price and (ii) supply from *PPC* will be on a firm basis until August 25, 2017, and on a non-firm basis from August 26, 2017 until end of the term thereof. All other terms and conditions under the *IPSAs*, as may be approved by the *ERC*, remain the same. Pursuant to provisions of the *IPSA*, in a letter dated November 10, 2017, *MERALCO* informed *TPC* and *PPC* that it is no longer interested in renewing their respective *IPSA*s, thus, the *IPSA*s will only be until February 25, 2018. As at July 30, 2018, the contract term has expired and *MERALCO* awaits the *ERC*'s final decision on the *IPSA*.

On January 24, 2017, in view of the Malampaya shutdown that was to coincide with the scheduled outage of other plants, *MERALCO* signed an *IPSA* with Strategic Power Development Corporation ("*SPDC*") for the supply of 100 *MW* per hour of electric power from 0901H to 1000H and from 2001H to 2100H, and 150 *MW* per hour of electric power from 1001H to 2000H, from January 28, 2017 until February 16, 2017. An application for approval of such *IPSA* was filed before the *ERC* on February 9, 2017. The said *IPSA* was effective immediately, on the condition that disallowances and penalties that the *ERC* may impose as a result thereof shall be for the account of *SPDC*. *MERALCO* and *SPDC*, in a letter agreement dated February 15, 2017, agreed to extend the term of the *IPSA* until March 25, 2017 under the same terms and conditions of the *IPSA*. On February 16, 2017, *MERALCO* and *SPDC* filed a Joint Manifestation with Motion with the *ERC* apprising the Honorable Commission of the extended term and praying that the same be duly considered and approved accordingly. The hearings on this case have been completed and *MERALCO* filed its *FOE* on July 21, 2017. As at July 30, 2018, the contract term has expired and *MERALCO* awaits the *ERC*'s final decision on the *IPSA*.

CEDC

SMEC

On March 20, 2013, *CEDC* and *SMEC*, as the Independent Power Producer Administrator of the Sual coal fired thermal power plant, entered into a *PSA* through December 25, 2019, unless terminated earlier in accordance with the terms of the Agreement. The initial contracted capacity from the plant was pegged at 55,000 *kWh* which may be increased up to 70,000 *kWh*.

On July 28, 2015, *CEDC* and *SMEC* filed a joint application for the amendment of the *PSA* for "*SMEC* to offer replacement contract capacity and associated energy form other sources, provided, such shall be lower than its forecast replacement power cost from *WESM*".

On September 30, 2016, the *ERC* approved an interim relief to allow *CEDC* to procure additional supply from *SMEC* in light of the planned outage of Sual Unit 1 from October 2016 to November 2016.

With the effectivity of *RCOA*, the various contestable customers shifted their power supply sourcing from the *CEDC* to their respective *RES*. In line with the switching, the *CEDC* and *SMEC* agreed to gradually lower the *PSA* contracted capacity by an aggregate of 40 *MW* in 2017 to manage the electric retail rates of captive customers.

SPDC

On February 20, 2017, *CEDC* executed an agreement for the supply of Contract Electric Energy with *SPDC*, the Independent Power Producer Administrator of the 345 *MW* San Roque Hydroelectric Power Plant in Barangay San Roque, San Miguel, Pangasinan. *CEDC* and *SPDC* agreed that the latter shall supply a total of 25 *MW*, consisting of 20 *MW* firm and 5 *MW* non-firm capacities during Mondays to Saturdays. This *PSA* was entered into by *CEDC* to diversify its source of capacity and also to mitigate its exposure to the *WESM* during the outages of its then lone power supplier, *SMEC*. The *PSA* was jointly filed by *CEDC* and *SPDC* on May 19, 2017 for *ERC* approval. As at July 30, 2018, no decision has been received from the *ERC* with regard to the application.

TransCo/ NGCP

CEDC entered into a Transmission Service Agreement ("*TSA*") with *TransCo* beginning March 30, 2006 until terminated, in accordance with the Open Access Transmission Service ("*OATS*") rules.

In January 2009, by virtue of *RA* No. 9511, *NGCP* has acquired the franchise to engage in *TransCo*'s business of conveying or transmitting electricity. *NGCP* eventually became *CEDC*'s transmission service supplier upon taking over the whole of *TransCo*'s regulated business.

With the termination of the previous *TSA*, *CEDC* executed a *TSA* on December 26, 2013 with *NGCP* for the provision of necessary transmission services in accordance with the *OATS* rules. The term of the *TSA* ends on December 25, 2018.

Interconnection Agreement with Alternergy Wind One Philippine Holdings Corporation ("Alternergy")

On March 1, 2012, *MERALCO* signed an Interconnection Agreement with *Alternergy* for the latter's 90 *MW* wind farm renewable energy plant in Pililla, Rizal, which shall interconnect at *MERALCO*'s Malaya-Teresa 115 *kV* line. *Altenergy* is an embedded generator. *Alternergy* shall construct at its own cost, operate and maintain the 115 *kV* line connecting its generating facility to *MERALCO*'s system. On September 3, 2014, *MERALCO* signed a supplement to the Interconnection Agreement with *Alternergy* to temporarily connect the latter's facilities to *MERALCO's* Malaya-Caliraya 115 *kV* line until December 31, 2015 and thereafter, proceed to the ultimate connection at the Malaya-Teresa 115 *kV* line. In its letter to *MERALCO* dated October 30, 2015, *Alternergy* expressed its intention to extend its use of the 115 *kV* line until the completion of the construction of the Phase 2 Line or until December 31, 2017. In the letter agreement dated December 2, 2015, *MERALCO* and *Alternergy* formalized their agreement regarding the extended use of said line.

Interconnection Agreement with Maibarara Geothermal, Inc. ("MGI")

On December 6, 2012, *MERALCO* signed an Interconnection Agreement with *MGI* for the latter's 20 *MW* (with maximum capacity of 40 *MW*) geothermal facility plant in Sto. Tomas, Batangas, which shall interconnect at *MERALCO*'s FPIP - Los Baños 115 *kV* line. *MGI* is an embedded generator. *MGI* shall construct at its own cost, operate and maintain the 115*kV* line connecting its generating facility to *MERALCO*'s system. In its Decision dated September 30, 2013, the *ERC* approved *MGI*'s application for authority to develop, own and operate dedicated point-to-point facilities to connect to the distribution system of *MERALCO*.

Interconnection Agreement with ATN Philippines Solar Energy Group, Inc. ("ATN")

On December 8, 2014, *MERALCO* signed an Interconnection Agreement with *ATN* for the latter's 25.2 *MW* solar generating facility in Rodriguez, Rizal, to be connected to *MERALCO*'s Novaliches 44 *YJ*, Diliman 435 *VU* and Parang 412 *YL* circuits. *ATN* is an embedded generator. *ATN* shall construct at its own cost, operate dedicated point-to-point lines and facilities that will connect its generating facility to *MERALCO*'s system. In its Decision dated June 8, 2015, the *ERC* approved *ATN's* application for authority to develop, own and operate a dedicated point-to-point lines and facilities.

Industry Restructuring

Under the *EPIRA*, the Philippine power industry continues to undergo fundamental restructuring.

These restructuring measures include:

- the deregulation of, and introduction of competition in, power generation and supply activities and pricing;
- the privatization of the *NPC*'s power generating assets and *IPP* contracts;
- the unbundling of the relative costs of the various segments of the power supply chain and reflecting these in the bills to customers;
- freedom of consumers to choose electricity suppliers;
- open and non-discriminatory access in the networks of *DU*s, subject to the fulfillment of certain conditions precedent;
- the implementation of the *WESM*; and
- removal of inter-grid, intra-grid, and inter-class cross-subsidies.

ELECTRIC POWER INDUSTRY DEVELOPMENTS AND UPDATES

1. Implementation of *PBR*

As *DU*s, *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC*. Billings of *MERALCO* and *CEDC* to customers are itemized or "unbundled" into a number of bill components that reflect the various activities and costs incurred in providing electric service. The adjustment to each bill component is governed by mechanisms promulgated and enforced by the *ERC*, mainly: [i] the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities", which govern the recovery of pass-through costs, including over- or under-recoveries of the bill components, namely, (a) generation charge, (b) transmission charge, (c) *SL* charge, (d) lifeline and inter-class rate subsidies, and (e) local franchise tax ("*LFT*"); and [ii] the "Rules for the Setting of Distribution Wheeling Rates" ("*RDWR*"), as modified by the *ERC* on December 1, 2009, which govern the determination of *MERALCO*'s distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in accordance with the *ERC* regulations. The following is a discussion of matters related to rate-setting of *MERALCO* and *CEDC*:

PBR

a. MERALCO

MERALCO is among the Group A entrants to the *PBR*, together with two (2) other private *DU*s.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs once every *RP* based on the *RAB* of each *DU*, and the required operating and capital expenditures to meet operational performance and

service level requirements responsive to the need for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC*. *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) *RY*s. An *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. The 4th *RP* for Group A *DU*s began on July 1, 2015 and shall end on June 30, 2019.

MAP for *RY 2012*

On June 21, 2011, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2012 and translation into rate tariffs by customer category. In an order dated October 3, 2011, the *ERC* provisionally approved the *MAP* for *RY* 2012 of ₱1.6012 per kilowatt hour ("*kWh*") and the rate translation per customer class was implemented starting October 2011. Hearings for the final approval of the application have been completed and all parties have submitted their respective memoranda. As at July 30, 2018, the application is pending final approval by the *ERC*.

MAP for *RY 2013*

On March 30, 2012, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2013 and the translation thereof into rate tariffs by customer category. On June 11, 2012, the *ERC* provisionally approved the *MAP* for *RY* 2013 of ₱1.6303 per *kWh*, which was reflected in the customer bills starting July 2012. Hearings on this case have been completed. As at July 30, 2018, the application is pending final approval by the *ERC*.

MAP for RY 2014

On April 1, 2013, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2014 of ₱1.6510 per *kWh* and the translation thereof into rate tariffs by customer category. On June 10, 2013, the *ERC* provisionally approved the *MAP* for *RY* 2014 of ₱1.6474 per *kWh* and the rate translation per customer class. As at July 30, 2018, the application is pending final approval by the *ERC*.

MAP for RY 2015

On March 31, 2014, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the translation thereof into rate tariffs by customer category. On May 5, 2014, the *ERC* provisionally approved *MERALCO*'s *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the rate translation per customer class. As at July 30, 2018, the application is pending final approval by the *ERC*.

4th RP Reset Application

MERALCO's 3rd *RP* ended on June 30, 2015 and is currently operating in the 4th *RP*. On April 12, 2016, to initiate the reset process, the *ERC* posted on its website the following draft issuance for comments:

a. Draft "Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Operating under Performance Based Regulation, First Entry Group: Fourth Regulatory Period";

b. Draft "Position Paper: Regulatory Reset for the July 1, 2015 to June 30, 2019 Fourth Regulatory Period for the First Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation"; and

c. Draft "Commission Resolution on the Issues on the Implementation of *PBR* for Privately Owned *DU*s under the *RDWR*".

Under *ERC* Resolution No. 25, Series of 2016 dated July 12, 2016, the *ERC* promulgated a Resolution modifying the *RDWR* for privately-owned *DU*s entering the *PBR*. The *ERC* has directed *MERALCO* and Private Electric Power Operators Association ("*PEPOA*") to publish the Resolution. However, *MERALCO* is seeking clarification from the *ERC* on certain issues in the Resolution, including the need to await the final decision of the *ERC* on the Petition for Rule Making filed by a consumer group to amend the *PBR*.

An initial hearing on the Petition for Rule Making filed by a consumer group was originally set by the *ERC* for January 9, 2017 and all interested parties were to file their comments on the Petition by December 26, 2016. *MERALCO* filed its Comment to the Petition on January 9, 2017.

Subsequently, however, the *ERC* reset the hearing to January 23, 2017. Hearings were further conducted on May 15 and June 21, 2017. As at July 30, 2018, the *ERC* Order for the date of the next public consultation is pending.

In a Notice dated November 16, 2016, the *ERC* approved the draft "Regulatory Asset Base Roll Forward Handbook for Privately Owned Electricity Distribution Utilities" ("*RAB Handbook*") for posting in its website. All interested parties had until December 19, 2016 to submit their respective comments to the draft *RAB Handbook*. Thereafter, during the public consultation on January 9, 2017, the parties were given until February 9, 2017 to file their comments to the draft *RAB Handbook*. In an Omnibus Motion filed on February 9, 2017, *MERALCO* submitted its initial comments to the draft *RAB Handbook* but moved for the deferment of the proceedings until the consumer group's Petition as referred in the foregoing has been resolved. As at July 30, 2018, the *ERC* has yet to resolve *MERALCO*'s Omnibus Motion.

Interim Average Rate for RY 2016

On June 11, 2015, *MERALCO* filed its application for the approval of a proposed Interim Average Rate of ₱1.3939 per *kWh* and translation thereof into rate tariffs by customer category. On July 10, 2015, the *ERC* provisionally approved an Interim Average Rate of ₱1.3810 per *kWh* and the rate translation per customer class, which was reflected in the customer bills starting July 2015. *MERALCO* has completed the presentation of its evidence and is set to file its Formal Offer of Evidence ("*FOE*") after the *ERC* rules on pending motions. As at July 30, 2018, the *ERC*'s ruling on these motions is pending.

Capital Expenditures ("CAPEX") for RY 2016

Absent the release by the *ERC* of the final rules to govern the filing of its 4th *RP* reset, *MERALCO* filed on February 9, 2015 an application for approval of authority to implement its *CAPEX* program for *RY* 2016 (July 1, 2015 to June 30, 2016) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act. On June 15, 2016, *MERALCO* received a copy of the *ERC* Decision dated April 12, 2016 which partially approved *MERALCO*'s *CAPEX* program for *RY* 2016 amounting to ₱15.5 billion out of the total *RY* 2016 *CAPEX* of ₱17.7 billion, subject to certain conditions. An intervenor has filed a *MR* on the Decision which is pending before the *ERC*. On July 25, 2016, *MERALCO* filed its opposition to the *MR*. As at July 30, 2018, the *ERC* ruling on the *MR*s is pending.

CAPEX for RY 2017

On March 8, 2016, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program for *RY* 2017 (July 1, 2016 to June 30, 2017) pursuant to the Public Service Act. On July 26, 2016, *MERALCO* received the Order dated May 5, 2016, which partially approved *MERALCO*'s *CAPEX* program for *RY* 2017 amounting to ₱8.8 billion out of the total *RY* 2017 *CAPEX* of ₱15.4 billion, subject to certain conditions. On August 10, 2016, *MERALCO* filed a Motion for Partial Reconsideration on the requirement to submit an accounting of the depreciation fund. Hearings on the application have been completed. On September 14, 2016, *MERALCO* filed a Motion for Resolution. Subsequently, on April 25, 2017, *MERALCO* filed a Very Urgent Motion for Resolution of the application. Thereafter, on October 18, 2017, *MERALCO* filed a Manifestation and Urgent Motion for Resolution. On November 9, 2017, *MERALCO* filed a Manifestation with Third Urgent Motion to Resolve the Application. As at July 30, 2018, *MERALCO* is awaiting the final decision of the *ERC*.

CAPEX for RY 2018

On April 3, 2017, *MERALCO* filed an application for approval of authority to implement its ₱18.8 billion *CAPEX* program for *RY* 2018 (July 1, 2017 to June 30, 2018) pursuant to the Public Service Act. On May 26, 2017, *MERALCO* received the Order dated May 15, 2017, which set the case for initial hearing. Hearings were conducted on June 22 and August 1, 2017, August 25, 2017 and September 22, 2017. A conference was also conducted with the *ERC* technical staff and the intervenor on October 12, 2017. On November 9, 2017, *MERALCO* filed its *FOE*. *MERALCO* also filed Manifestations on November 9, 2017 and March 28, 2018, informing the *ERC* that it was constrained to implement several projects in order to avert service interruptions to its customers and maintain a robust distribution infrastructure. As at July 30, 2018, the case has been submitted for decision.

CAPEX for RY 2019

On April 30, 2018, *MERALCO* filed an application for approval of authority to implement its ₱21 billion *CAPEX* program for *RY* 2019 (July 1, 2018 to June 30, 2019) pursuant to the Public Service Act. On July 9, 2018, *MERALCO* filed a Very Urgent Motion for Issuance of Provisional Authority and to set case for initial hearing. As at July 30, 2018, *MERALCO* is awaiting further action of the *ERC*.

CEDC

CEDC is among the four (4) Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. A *RY* for *CEDC* begins on October 1 and ends on September 30. The 3rd *RP* for *CEDC* began on October 1, 2015 and shall end on September 30, 2019. *CEDC* is to undergo the reset process and is awaiting the release by the *ERC* of the final rules to govern the filing of its 3rd *RP* reset application.

3rd RP PBR Reset for CEDC

Pending the release by the *ERC* of the final rules to govern the filing of its 3rd *RP* Reset application and absence of subsequent rate translation process thereto, the approved *MAP* for *RY* 2015 was used beginning *RY* 2016.

On February 18 and December 29, 2016, *CEDC* filed with the *ERC* its Proposed *CAPEX* program for *RY*s 2016 and 2017, respectively. *CEDC* applied for an approval to implement the *CAPEX* in order to continue to meet the electricity needs of its current and future customers, improve the flexibility, reliability and stability of its distribution network as well as improve customer service.

2. Application for Recoveries

Applications for the Confirmation of Over/Under-recoveries of Pass-through Charges

MERALCO

On July 13, 2009, the *ERC* issued Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities". These rules govern the recovery of pass-through costs, including under- or over-recoveries with respect to the following bill components: generation charge, transmission charge, *SL* charge, lifeline and inter-class rate subsidies, *LFT* and business tax. On October 18, 2010, the *ERC* promulgated *ERC* Resolution No. 21, Series of 2010, amending the *SL* true-up formula contained in Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for *DU*s in Luzon to file their respective applications. Subsequent filings shall be made every three (3) years thereafter. On December 15, 2010, the *ERC* promulgated Resolution No. 23, Series of 2010 to govern the recovery of Senior Citizen Discounts and specified that post-verification shall coincide with the timeframes in Resolution No. 16, Series of 2009, as amended by Resolution No. 21, Series of 2010.

On March 31, 2011, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries accumulated from June 2003 to December 2010 in compliance with Resolution No. 16, Series of 2009, as

subsequently amended by Resolution No. 21, Series of 2010. On December 8, 2011, *MERALCO* filed a Manifestation with Omnibus Motion praying, among other things, for the admission of the Supplemental Application, which was admitted by the *ERC* in an Order dated December 12, 2011. The filing includes net generation charge under-recoveries of ₱1,000 million, net transmission charge over-recoveries of ₱111 million, net lifeline subsidy under-recoveries of ₱9 million and net *SL* over-recoveries of ₱425 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*'s application for the confirmation of its over- or under-recoveries in its pass-through costs for the period June 2003 to December 2010. The Decision directed *MERALCO* to collect net under-recoveries of ₱909 million, without carrying charges, starting the next billing cycle until such time that the full amount has been collected. The amount has been fully recovered in 2017.

On July 6, 2012, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries for the calendar year 2011. The filing includes net generation charge under-recoveries of ₱1,826 million, net transmission charge under-recoveries of ₱253 million, net lifeline subsidy under-recoveries of ₱39 million and *SL* over-recoveries of ₱445 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*'s application for the confirmation of its over- or under-recoveries in its pass-through costs for the period January to December 2011. The Decision directed *MERALCO* to collect net under-recoveries of ₱1,535 million, without carrying charges, starting the next billing cycle until such time that the full amount has been collected. The amount has been fully recovered in 2017.

On March 31, 2014, *MERALCO* filed its application with the *ERC* to confirm its under- or over- recoveries of net generation charge under-recoveries of ₱559 million, transmission charge over-recoveries of ₱639 million, net lifeline subsidy over-recoveries of ₱75 million, *SL* over-recoveries of ₱502 million from January 2012 to October 2013, and net senior citizen discount over-recoveries of ₱0.4 million from February 2011 to October 2013, excluding proposed carrying charges. Under- or over-recoveries from November and December 2013 supply months were excluded in the meantime, in view of the pending *SC* and *ERC* cases involving pass-through costs for these months. As at July 30, 2018, hearings are ongoing.

On January 29, 2016, *MERALCO* filed its application to confirm its under-recoveries of generation charge for special programs of ₱250.7 million, excluding carrying charges, covering the period March 2007 to December 2011. As at July 30, 2018, the application is pending before the *ERC*.

On March 31, 2017, *MERALCO* filed its application with the *ERC* to confirm its net generation charge over-recoveries of ₱4,919 million, net transmission charge over-recoveries of ₱632 million, net lifeline subsidy over-recoveries of ₱131 million, net *SL* over-recoveries of ₱1,243 million, net senior citizen discount over-recoveries of ₱2 million from January 2014 to December 2016 and real property tax ("*RPT*") payments under-recoveries of ₱1,090 million from June 2014 to December 2016. On May 11, 2017, the *ERC* provisionally approved *MERALCO*'s application to refund the over-recoveries of pass-through charges (generation costs, transmission costs, system loss, life line subsidies and senior citizen discount subsidy) for the period January 2014 to December 2016 amounting to ₱6,927 million. The Order deferred action on *MERALCO*'s application for the recovery of *RPT* payments, citing the absence of any rule or guideline providing for the process of confirmation, approval and recovery of *RPT*. The ₱6,927 million refund was included in the June 2017 until August 2017 billings to customers. On September 7, 2017, *MERALCO* filed a Manifestation and Motion informing the *ERC* that the absolute amounts of the remaining over/under recoveries were applied to the September 2017 billing in order to zero out the refund as directed by the *ERC*. *MERALCO* filed its *FOE* on April 27, 2018. As at July 30, 2018, the application is pending final approval before the *ERC*.

CEDC

CEDC filed its application for the approval of the calculations for the Automatic Cost Adjustment and True-up Mechanism for generation, transmission and system loss rates on April 1, 2014 in conformity with the said resolutions. Public hearing was held on June 17, 2014 and the *ERC* decision was received by *CEDC* on January 13, 2017. On January 30, 2017, *CEDC* filed a *MR* on the decision of the *ERC*. As at July 30, 2018, the *MR* is pending decision by the *ERC*.

On March 31, 2017, *CEDC* filed with the *ERC* its second application for the approval of the calculations for the Automatic Cost Adjustment and True-up Mechanism for generation, transmission and system loss rates which

covered years 2014, 2015 and 2016. Public hearing was held on October 25, 2017. As at July 30, 2018, the Decision of the *ERC* is pending.

Application for Approval of the Staggered Recovery and Payment of the Differential Generation Charge for February 2017 Supply

On January 31, 2017, *MERALCO* filed an Application seeking the *ERC*'s approval of the staggered recovery and payment scheme for the generation charge for the February 2017 supply month to mitigate the impact of scheduled outages and maintenance of certain generation power plants. On March 6, 2017, the *ERC* provisionally approved the recovery of the incremental fuel cost through a staggered scheme. The incremental fuel cost was included in the March 2017 until May 2017 billings to customers. As at July 30, 2018, hearings are ongoing.

Application for the Recovery of Differential Generation Costs

On February 17, 2014, *MERALCO* filed for the recovery of the unbilled generation costs for December 2013 supply month amounting to ₱11,075 million. An amended application was filed on March 25, 2014 to adjust the unbilled generation costs for recovery to ₱1,310 million, following the receipt of Wholesale Electricity Spot Market ("*WESM*") billing adjustments based on regulated Luzon *WESM* prices. The first hearing was conducted on May 26, 2014. The *ERC* suspended the proceedings, pending resolution of issues of related cases at the *SC* involving generation costs for the November and December 2013 supply months and the regulated *WESM* prices for the said period. As at July 30, 2018, the proceedings remain suspended.

Deferred Purchased Price Adjustment ("Deferred PPA")

On October 12, 2009, the *ERC* released its findings on *MERALCO*'s implementation of the collection of the approved pass-through cost under-recoveries for the period June 2003 to January 2007. The *ERC* directed *MERALCO* to refund to its customers ₱268 million of Deferred *PPA* transmission line costs related to Quezon Power (Philippines) Limited Company ("*QPPL*") and deferred accounting adjustments incurred along with ₱184 million in carrying charges, or an equivalent ₱0.0169 per *kWh*. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s *Deferred PPA* under-recoveries of ₱106 million, which is not a transmission line fee. On November 4, 2009, *MERALCO* filed an *MR* with the *ERC*. As at July 30, 2018, the *MR* is still pending resolution by the *ERC*.

Application for Recovery of LFT

On March 25, 2011, *MERALCO* filed with the *ERC* its application for recovery of *LFT* paid but not yet billed to customers for the period beginning the first quarter of 1993 up to the second quarter of 2004 for five (5) provinces, namely: Bulacan, Batangas, Cavite, Laguna and Rizal; and 14 cities, namely: San Jose Del Monte, Batangas, San Pablo, Tagaytay, Lucena, Mandaluyong, Marikina, Quezon, Caloocan, Pasay, Las Piñas, Manila, Pasig and Calamba. The *LFT* is recognized as a valid and reasonable *DU* pass-through cost in the *ERC*'s unbundling decision.

In a Decision dated February 27, 2012, the *ERC* approved with modifications *MERALCO*'s application. The *ERC* approved the recovery of *LFT* amounting to ₱1,571 million plus carrying charges of ₱730 million. As directed by the *ERC*, the recovery was reflected as a separate item in the *MERALCO* billing statement to its customers beginning April 2012. In 2017, the *LFT* plus carrying charges have been fully recovered.

On June 14, 2013, *MERALCO* filed an application with the *ERC* for authority to collect *LFT* from customers of the City of Trece Martires, with prayer for provisional authority, beginning the date of effectivity of "*The 2012 Revenue Code of Trece Martires City*" on July 1, 2012. In its Decision dated April 28, 2014, the *ERC* approved said application, with modification, and authorized *MERALCO* to recover the new *LFT* at the rate of 82.5% of 1%, prospectively, or effective its next billing cycle. With respect to the difference between the previous and the new *LFT* rates from the time said revenue code took effect, the *ERC* stated in its Decision that the same shall be considered in a separate application to be filed by *MERALCO* in accordance with the Tax Recovery Adjustment Charges ("*TRAC*") Formula under *ERC* Resolution No. 16 Series of 2009. On July 24, 2014, *MERALCO* filed a motion seeking the partial reconsideration of the Decision in so far as the filing of a separate application for *LFT* for the prior years is concerned. On October 30, 2014, *MERALCO* received the *ERC*'s Order dated September 24, 2014 denying *MERALCO*'s motion. In said Order, the *ERC* maintained its position that it shall consider in a

separate application the difference between the previous and the new *LFT* rates from the time said revenue code took effect. On February 23, 2015, *MERALCO* paid the full amount of said *LFT* to the City Treasurer of Trece Martires.

On July 3, 2015, *MERALCO* filed the application for authority to recover the difference between the previous and new *LFT* rate for the calendar years 2012 to 2014 in the City of Trece Martires, under the *TRAC* formula with prayer for provisional authority, where it prayed for authority to collect from the customers in the City of Trece Martires the *LFT* amounting to ₱2 million for 2012 to 2014, which it had previously paid to the City of Trece Martires and the corresponding carrying cost**.** Hearings have been completed. On September 29, 2015, *MERALCO* filed its *FOE* with Manifestation and Compliance and thereby submitted the case for resolution. In a decision dated May 10, 2016, the *ERC* approved the application with modification.

On December 5, 2016, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Manila and Quezon City as well as for authority to refund the differential *LFT* for 2014 to 2016 under the *TRAC* formula. Hearings have been completed and *MERALCO* filed its *FOE* on June 2, 2017. However, a consumer filed a motion to intervene after the termination of the proceedings. On June 23, 2017, *MERALCO* filed its opposition thereto. As at July 30, 2018, the *ERC* resolution of the motion to intervene is pending.

On October 25, 2017, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Biñan as well as for authority to refund the differential *LFT* for 2017 under the *TRAC* formula. In its Decision dated June 18, 2018, the *ERC* provisionally approved said application, and authorized *MERALCO* to recover the new *LFT* at the rate of 75% of 1% beginning on the date of effectivity thereof, or on January 1, 2017 and to recover the differential *LFT* in the amount of ₱10.9 million at a rate of ₱0.0117 per *kWh* and carrying cost in the amount of ₱0.4 million at a rate of ₱0.0121 per *kWh* from the customers in the City of Biñan over a period of 12 months. The case is set for initial hearing on August 20, 2018.

3. Benefit Sharing Scheme to Lower *SL*

On January 26, 2011, *MERALCO*, together with *PEPOA* and Philippine Rural Electric Cooperative Association ("*PHILRECA*"), filed a joint petition to the *ERC* to initiate rule-making to adopt the Proposed Guidelines for the Implementation of an Incentive Scheme to Lower the System Losses of Private Distribution Utilities and Electric Cooperatives to Level Below the System Loss Cap, for the Benefit of End-Users. This was aimed to encourage the *DU*s to reduce *SL* levels below the cap set by the *ERC* and benefit the end-users through lower *SL* charges. Public hearings were conducted and completed on June 15, 2011.

On December 11, 2012, the *ERC* posted on its website the second draft of the Rules to Govern the Implementation of a Benefit Sharing to Lower the System Losses of Electric Distribution Utilities. As at July 30, 2018, the Joint Petition is pending further action or decision by the *ERC*.

4. *RCOA*

The transition period for *RCOA* commenced on December 26, 2012 in accordance with the joint statement released by the *ERC* and the *DOE* on September 27, 2012 and the Transitory Rules for the Implementation of *RCOA* (*ERC* Resolution No. 16, Series of 2012). The commercial operations of *RCOA* started on June 26, 2013.

On March 31, 2014, the *ERC* issued a resolution on the Withdrawal of the Rules on Customer Switching and the Retention of the Code of Conduct for Competitive Retail Market Participants. On the same date, *ERC* also issued a resolution adopting the Rules on the Establishment of Customer Information by the Central Registration Body ("*CRB*") and Reportorial Requirements, mandating all *DU*s to submit to the *ERC* and *CRB* information on end-users with (i) monthly average peak demand of at least one (1) *MW* for the preceding 12 months; and (ii) monthly average peak demand of 750 *kW* but not greater than 999 *kW*. The *ERC* will use these information in issuing the certificates of contestability.

On October 22, 2014, the *ERC* issued a resolution suspending the issuance of *RES* licenses. Under the resolution, the *ERC* resolves to hold in abeyance the evaluation of *RES* license applications and suspend the issuance of such licenses until such time that the amendments to the Rules for the issuance of *RES* licenses have been made by the *ERC*.

On July 1, 2015, the *DOE* published Department Circular No. DC2015-06-0010, "Providing Policies to Facilitate the Full Implementation of *RCOA* in the Philippine Electric Power Industry". The Circular essentially provided for mandatory contestability.

On March 8, 2016, the *ERC* promulgated Resolution No. 05 Series of 2016 entitled *"*A Resolution Adopting the 2016 Rules Governing the Issuance of Licenses to Retail Electricity Suppliers (RES) and Prescribing the Requirements and Conditions Therefor*"*. The Resolution removed the term local *RES* as one of the entities that may engage in the business of supplying electricity to the contestable market without need of obtaining a license therefor from the *ERC*. Moreover, while an affiliate of a *DU* is allowed to become a *RES*, the allowance is "subject to restrictions imposed by the *ERC* on market share limits and the conduct of business activities".

On May 12, 2016, the *ERC* issued Resolutions No. 10 and 11, Series of 2016, which:

1. Provides for mandatory contestability. Failure of a contestable customer to switch to *RES* upon date of mandatory contestability (December 26, 2016 for those with average demand of at least one (1) *MW* and June 26, 2017 for at least 750 *MW*) shall result in the physical disconnection from the *DU* system unless it is served by the Supplier of last resort ("*SOLR*"*)*, or, if applicable, procures power from the *WESM;*

2. Prohibits *DU*s from engaging in the supply of electricity to the contestable market except in its capacity as a *SOLR;*

3. Mandates Local *RES*s to wind down their supply businesses within a period of three (3) years;

4. Imposes upon all *RES*s, including *DU*-affiliate *RES*s, a market-share cap of 30% of the total average monthly peak demand of all contestable customers in the competitive retail electricity market; and,

5. Prohibits *RES*s from transacting more than 50% of the total energy transactions of its supply business, with its affiliate contestable customers.

On May 27, 2016, *MERALCO* filed a Petition before *RTC-Pasig*, praying that: (a) a *TRO* and subsequently a Writ of Preliminary Injunction ("*WPI*") enjoining the *DOE* and *ERC* from implementing the assailed rules be issued; and the assailed rules be declared null and void for being contrary to the *EPIRA* and its *IRR*. In an Order dated June 13, 2016, *RTC-Pasig* granted a 20-day *TRO*, which became effective on June 16, 2016. In an Order dated July 13, 2016, *RTC-Pasig* granted a *WPI*, which became effective on July 14, 2016, and shall be effective for the duration of the pendency of the Petition.

Meanwhile, the *ERC* filed a Petition for Certiorari and Prohibition with prayer for *TRO* and/or *WPI* before the *SC*, which asserted that *RTC-Pasig* has no jurisdiction to take cognizance of *MERALCO*'s Petition, citing Sec. 78 of the *EPIRA*. A similar petition was subsequently filed by the *DOE* before the *SC*.

On October 10, 2016, the *SC*, in relation to the Petition filed by the *DOE*, issued a *TRO* that restrained, *MERALCO*, the *RTC-Pasig*, their representatives, agents or other persons acting on their behalf from continuing the proceedings before the *RTC-Pasig*, and from enforcing all orders, resolutions and decisions rendered in Special Civil Action No. 4149 until the petition before the *SC* is finally resolved. In a Resolution dated November 9, 2016, the *SC* denied *MERALCO*'s *MR*.

On November 2, 2016, in relation to the Petition filed by the *ERC*, the *SC* issued a Resolution dated September 26, 2016, which partially granted the Petition of the *ERC*. While the *SC* allowed the *RTC-Pasig* to proceed with the principal case of declaratory relief, it nonetheless issued a Preliminary Mandatory Injunction ("*PMI*") against *RTC-Pasig* to vacate the preliminary injunction it previously issued, and Preliminary Injunction ("*PI*") ordering the *RTC-Pasig* to refrain issuing further orders and resolutions tending to enjoin the implementation of *EPIRA*. On November 14, 2016, *MERALCO* filed a Motion for Partial Reconsideration with Very Urgent Motion to lift *PMI*/*PI*.

On November 24, 2016, the *ERC* promulgated a resolution moving the contestability date of end users with an average monthly peak demand of at least one (1) *MW* from December 31, 2016 to February 26, 2017. On January 17, 2017, *MERALCO*, through its counsel, received an *SC* Resolution dated December 5, 2016, which

consolidated the *SC DOE* Petition with the *SC ERC* Petition. The same resolution also denied the Motion for Partial Reconsideration filed by *MERALCO*.

In relation to the *ERC* and *DOE* Petitions, a separate Petition for Certiorari, Prohibition and Injunction was filed by several institutional customers. In said Petition, said customers sought to declare as null and void, as well as to enjoin the *DOE* and *ERC* from implementing *DOE* Circular No. 2015-06-0010 and *ERC* Resolution Nos. 5, 10, 11 and 28, Series of 2016. Acting on the Petition, the *SC en banc* through a Resolution dated February 21, 2017, issued a *TRO* enjoining the *DOE* and the *ERC* from implementing *DOE* Circular No. 2015-06-0010 and *ERC* Resolution Nos. 5, 10, 11 and 28, Series of 2016. Pursuant to the foregoing, *PEMC* has taken the position that the *TRO* enjoined the voluntary contestability of 750 *kW* to 999 *kW* customers and has not allowed them to switch to the contestable market. The *DOE*, in a press release, has advised that it is in the process, together with *PEMC* and *ERC*, of drafting a general advisory for the guidance of *RCOA* stakeholders. The *PCCI* petition was consolidated with two (2) other separate petitions filed by an educational institution and several *DU*s. The *DOE* and *ERC* have also filed a consolidated comment on these petitions.

On November 29, 2017, the *DOE* issued two (2) *DOE* Circulars, namely: DC 2017-12-0013, entitled, Providing Policies on the Implementation of *RCOA* for Contestable Customers in the Philippines Electric Power Industry and DC 2017-12-0014, entitled Providing Policies on the Implementation of *RCOA* for *RES* in the Philippine Electric Power Industry. The *DOE* Circulars became effective on December 24, 2017.

Under the *DOE* Circular No. DC 2017-12-0013, it is provided that voluntary participation for contestable customers under *RCOA*-Phase 2 shall now be allowed upon effectivity of said Circular, while voluntary participation of contestable customers with a monthly average peak demand of 500 *kW to* 749 *kW* for the preceding 12 months and demand aggregation for electricity end users within a contiguous area with an aggregate average peak demand of not less than 500 *kW* for the preceding 12-month period, will also be allowed by June 26, 2018 and December 26, 2018, respectively.

On December 22, 2017, *MERALCO* wrote *ERC* and *DOE* to seek guidance on the impact of the *DOE* Circulars in the light of the *TRO* issued by the *SC*. On January 17, 2018, the *DOE* responded that there is no legal impediment to the implementation of the *DOE* Circulars but it defers to the *OSG* for guidance on the legal aspect of the issuances. As at July 30, 2018, the *ERC* has yet to respond to *MERALCO*'s letter.

5. Interim Pre-Emptive Mitigating Measure in the *WESM*

On May 5, 2014, the *ERC* issued Resolution No 8, Series of 2014, setting an interim pre-emptive mitigating measure in the *WESM*, which established a price threshold in the *WESM* applied over a 72-hour period, which is determined through a rolling average generated weighted average price ("*GWAP*") of ₱8,186 per *MWh*. Also, a secondary cap amounting to ₱6,245 per *MWh* is imposed upon a breach of the threshold, or secondary cap mechanism. Such interim measure aims to mitigate sustained high prices in the *WESM* during the May and June 2014 supply months. On June 16, 2014, the *ERC* issued another resolution extending the effectivity of the pre-emptive mitigating measure for 45 days from expiration or until August 9, 2014. Public consultation and a subsequent focus group discussion were held on July 23 and 25, 2014, respectively. On August 5, 2014, the *ERC* resolved to (i) adopt a permanent pre-emptive mitigating measure that will be applied in the *WESM*; (ii) direct all interested stakeholders to submit their proposed measures within 20 days from effectivity of such resolution; and (iii) extend the effectivity of the secondary cap mechanism for a period of 120 days from August 10, 2014 or until the *ERC* establishes a permanent pre-emptive mitigating measure in the *WESM*, whichever comes earlier.

On September 29, 2014, the *ERC* conducted a public consultation on the proposed permanent pre-emptive mitigating measures in the *WESM*. Parties were then given until October 7, 2014 to file their additional comments, if any.

On October 24, 2014, the *WESM* Tripartite Committee issued a Joint Resolution to further extend the interim offer price cap in the *WESM* for 120 days starting October 24, 2014 to harmonize with the finalization of the permanent pre-emptive mitigating measure which shall be applied in the *WESM*. On February 20, 2015, the *WESM* Tripartite Committee issued a joint resolution which extended further the imposition of the interim *WESM* offer price cap at its current level until September 30, 2015.

In December 2014, in its Resolution No. 20, Series of 2014, the *ERC* adopted and established a permanent pre-emptive mitigation measure in the *WESM*. The *ERC* set a cumulative price threshold ("*CPT*") amounting to an average spot price of ₱9,000 per *MWh* over a rolling 7-day period or 168-hour trading interval. Once this *CPT* for said period is breached, it triggers the imposition of a price cap amounting to ₱6,245 per *MWh*. The price cap shall be imposed until after a determination that succeeding *GWAP* rolling average is already below the *CPT*. The pre-emptive measure has taken effect beginning January 9, 2015.

The imposition of the mitigating measure was questioned by the Philippine Independent Power Producers Association ("*PIPPA*") in the *RTC-Pasig* through a Petition for Declaratory Relief with Application for *TRO* and/or Writ of Preliminary Injunction. The Petition prayed for, among others, that the *ERC* Resolutions pertaining to the secondary cap mechanism be declared void *ab initio*. The original petition was subsequently amended to reflect the promulgation of the subsequent *ERC* resolutions extending the effectivity of the *WESM* price cap. On July 21, 2014, *MERALCO* filed its Motion for Leave to Intervene and to Admit Attached Comment in Intervention. The *RTC-Pasig* admitted *MERALCO'*s intervention and comment in its Order dated October 28, 2014. However, in a Motion for Leave to Admit Supplement Petition, *PIPPA* moved for leave to file a supplemental petition to include *ERC* Resolution No. 20, Series of 2014 which provides for a permanent mitigating measure in the *WESM*. In an Order dated May 5, 2015, the *RTC*-Pasig denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a Motion for Partial Reconsideration which was denied by the *RTC*-Pasig in its Resolution dated September 10, 2015. *PIPPA* filed a Petition for Certiorari with the *CA*. The *CA* denied the Petition for Certiorari in its Decision dated June 9, 2017. *PIPPA* filed a *MR* dated July 19, 2017. In a Resolution dated August 16, 2017, the parties were directed to file their comments to the *PIPPA*'s *MR*. *MERALCO* has filed its comment on the *MR*. On April 4, 2018, the *CA* rendered a resolution denying the *MR* filed by *PIPPA*.

On September 29, 2015, the *WESM* Tripartite Committee issued a Joint Resolution further extending the interim offer price cap of ₱32,000 per *MWh* until December 31, 2015. In its Joint Resolution No. 3, Series of 2015, the *WESM* Tripartite Committee resolved to set the *WESM* offer price cap at ₱32,000 per *MWh* and the *WESM* offer price floor of negative ₱10,000 per *MWh* effective January 2016, provided that an annual review shall be undertaken considering the relevant costs assumptions at the time of review.

On December 7, 2015, the *RTC-Pasig* rendered a Decision dismissing the Petition for Declaratory Relief. The *MR* filed by *PIPPA* was denied in a Resolution dated June 16, 2016. *PIPPA* appealed the *RTC-Pasig* Decision with the *SC*. *MERALCO* has filed its comment thereto. *PIPPA* filed a Consolidated Reply on July 17, 2017. As at July 30, 2018, the case is pending before the *SC*.

On May 9, 2017, the *ERC* issued Resolution No. 4, Series of 2017, entitled, "A Resolution Adopting Amendments to the Pre-emptive Mitigating Measure in the *WESM*". They adopted a recalculated cumulative price threshold level of ₱1,080,000 and a shorter five (5) -day (120-hour) rolling average period. This is equivalent to ₱9,000 per *MWh* over said period.

6. Philippine Economic Zone Authority ("*PEZA") – ERC* Jurisdiction

On September 13, 2007, *PEZA* issued "Guidelines in the Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones" and "Guidelines for the Supply of Electric Power in Ecozones" ("*Guidelines*"). Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DU*s which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DU*s in *RTC-Pasig*.
On February 4, 2015, the *RTC-Pasig* issued an Order setting a clarificatory hearing on April 15, 2015. During the said hearing, *MERALCO* manifested that it previously filed a Motion to Withdraw as plaintiff on the basis of letter agreements between *MERALCO* and *PEZA*, which is pending before the *RTC-Pasig*. *MERALCO* submitted the Tripartite Agreement among *PEZA*, *PEPOA* and *MERALCO* for approval of the *RTC-Pasig*. In a Decision dated July 3, 2015, the *RTC-Pasig* approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2016, the *RTC-Pasig* dismissed the petition upon motion by *PEZA*. The *ERC* filed a *MR* which is pending resolution by the *RTC-Pasig*.

7. Decision on the ₱0.167 per *kWh* Refund

Following the *SC*'s final ruling that directed *MERALCO* to refund affected customers ₱0.167 per *kWh* for billings made from February 1994 to April 2003, the *ERC* approved the release of the refund in four (4) phases. On December 18, 2015, *MERALCO* filed a Motion seeking the *ERC*'s approval for the continuation of the implementation of the refund to eligible accounts or customers under Phases I to IV, three (3) years from January 1, 2016 or until December 31, 2018. In said Motion, *MERALCO* likewise manifested to the *ERC* that, in order to give eligible customers the opportunity to claim their refund, and, so as not to disrupt the *SC* Refund process, *MERALCO* shall continue implementing the refund even after the December 2015 deadline, until and unless the *ERC* directs otherwise.

8. Purchase of Subtransmission Assets *("STA*s")

On April 17, 2012, *MERALCO* and *TransCo* filed a joint application for the approval of the Batch 4 contract to sell with the *ERC*. On April 22, 2013, the *ERC* issued a Decision on *MERALCO*'s joint application for the acquisition of the Batch 4 contract to sell. On June 21, 2013 and July 3, 2013, *MERALCO* and *TransCo* filed a Motion for Partial Reconsideration and *MR*, respectively, regarding the exclusion of certain facilities for acquisition.

On May 22, 2014, *MERALCO* and *TransCo* received an *ERC* Order dated May 5, 2014 denying *MERALCO* and *TransCo*'s Motions. On June 5, 2014, *MERALCO* filed a clarificatory motion and a *MR* of the May 5, 2014 *ERC* Order, which was denied by the *ERC* through an Order dated June 16, 2014. On October 10, 2014, *MERALCO* filed a Motion to Reopen Proceedings for the reception of new evidence to support *MERALCO*'s position on the acquisition of excluded *STAs*. The Motion was heard by the *ERC* on October 17, 2014. After the parties have submitted their respective comments and pleadings, the *ERC* conducted another hearing on February 23, 2015. During the hearing, *TransCo* was given three (3) days from the said date to file its Comment on the subsequent pleadings filed, after which the case is deemed submitted for resolution.

In an Order dated March 4, 2015, the *ERC* considered but denied the new and substantive allegations in *MERALCO*'s Motion to Reopen Proceedings. *MERALCO* then filed a Petition for Review with the *CA* to question the Orders of the *ERC*. In a Decision dated August 12, 2016, the *CA* dismissed the Petition. On September 17, 2016, *MERALCO* filed a *MR*. In an Amended Decision dated September 15, 2017, the *CA* granted *MERALCO*'s *MR* and approved the sale of the Dasmarinas-Abubot-Rosario 115 *kV* line and Rosario substation equipment in favor of *MERALCO*. *NGCP* filed a *MR* (of the Amended Decision) dated October 4, 2017. In a Resolution dated May 31, 2018, the *CA* denied the *MR*. *NGCP* filed a Petition for Review with the *SC*. *MERALCO* is currently preparing its Comment to the Petition.

On March 20, 2015, *MERALCO* filed a case for "Interpleader with Consignation and Specific Performance" against *TransCo* and the Municipality of Labrador, Pangasinan ("*Labrador*") with the *RTC-Pasig*, praying for the *RTC-Pasig* to (i) accept and approved the consignation of the amount of ₱194.1 million; (ii) declare *MERALCO* to have paid in full the purchase price of the sale of *TransCo*'s assets; (iii) direct *TransCo* to execute the corresponding Deeds of Absolute Sale; and (iv) direct *Labrador* and *TransCo* to interplead their respective claims. On April 14 and 20, 2015, *Labrador* and *TransCo* filed their respective Motions to Dismiss on the ground of impropriety of the filing of the Interpleader and on the ground of *litis pendentia*. *MERALCO* received an Order from *RTC-Pasig* granting the Motions to Dismiss of both *TransCo* and *Labrador*. *MERALCO* filed a *MR* which is pending resolution. In a Letter dated December 27, 2017, *Labrador* denied *TransCo*'s request for settlement of the warrant of distraints issued by said city against *TransCo*'s properties, including the subject properties for local business tax claims. As at July 30, 2018, *MERALCO* is awaiting for *CA*'s decision before any action may be taken in relation to the contract to sell.

On December 15, 2016, *MERALCO* and *TransCo* filed a joint application for the approval of the Batch 3 contract to sell with the *ERC*. The case is set for initial hearing on August 10, 2018.

9. Feed-in-Tariff *("FiT")*

Pursuant to *RA* No. 9513, or the Renewable Energy Act of 2008 ("*RE* Act"), the *ERC* issued Resolution No. 16, Series of 2010, Adopting the *FiT* Rules, on July 23, 2010. As defined under the *FiT* Rules, the *FiT* system is as

a renewable energy policy that offers guaranteed payments on a fixed per *kWh* for electricity from wind, solar, ocean, hydropower and biomass energy sources, excluding any generation for own use.

On May 16, 2011, the National Renewable Energy Board ("*NREB*") filed its Petition to Initiate Rule Making for the Adoption of *FiT*. The Petition proposed a specific *FiT* Rate for each emerging renewable resource. On July 27, 2012, after undergoing several public consultations and public hearings, the *ERC* approved *FiT* Rates lower than the rates applied by the *NREB*.

To fund the *FiT* payments to eligible *RE* developers, a *FiT-All* charge shall be imposed on all end-users. The *FiT-All* will be established by the *ERC* upon petition by *TransCo*, which had been designated as the *FiT* Fund Administrator.

On February 5, 2014, the *ERC* released the *FiT-All* disbursement and Collection Guidelines ("*FiT Guidelines*") to supplement the *FiT* Rules. This set of guidelines will govern how the *FiT-All* will be calculated using the formulae provided. It will also outline the process of billing and collecting the *FiT-All* from the electricity consumers, the remittance to a specified fund, the disbursement from the *FiT-All* fund and the payment to eligible *RE* developers.

On July 30, 2014, *TransCo* filed its Application for Approval of the *FiT-All* for calendar years 2014 and 2015. On October 7, 2014, the *ERC* provisionally approved a *FiT-All* of ₱0.0406 per *kWh* effective in the January 2015 billing as a separate line item in the bills of end consumers. In its letter to *MERALCO* dated December 18, 2014, the *ERC* clarified that the January 2015 billing covers consumption of customers for the period December 26, 2014 to January 25, 2015.

On December 23, 2014, *MERALCO* received a copy of a Petition for Prohibition and Certiorari filed with the *SC* against the *ERC*, *DOE*, *TransCo*, *NREB* and *MERALCO*. The Petition seeks (i) the issuance of a *TRO* and/or *WPI*, and after giving due course to the Petition, a Writ of Prohibition to enjoin the respondents from implementing the *FiT-All*, the *FiT* Rules and *FiT* Guidelines; and (ii) the annulment of the *FiT* Rules and *FiT* Guidelines. The parties have been directed to submit their respective memoranda.

On April 30, 2014, the *DOE* issued a certification revising the installation target for solar from 50 *MW* to 500 *MW*, an additional capacity of 450 *MW*. In its certification, the *DOE* stated that "solar energy generation projects given their short installation period can greatly contribute in providing additional generating and reserve capacity in the summer seasons of 2015 and 2016".

On January 28, 2015, the *ERC* conducted a public consultation on the increase of the installation target for solar renewable energy generation (additional 450 *MW*) and the *FiT* Rate for the additional solar capacity. In the said hearing, it was clarified that the additional 450 *MW* installation capacity for solar is already approved by the *DOE*. On April 28, 2015, the *ERC* issued a Decision dated March 27, 2015 setting the new solar *FiT* Rate at ₱8.69 per *kWh*, which shall apply prospectively.

On April 7, 2015, the *DOE* issued a certification revising the installation target for wind from 200 *MW* to 400 *MW*. On April 13, 2015, the *ERC* initiated the review of the *FiT* for wind technology. In a letter dated April 15, 2015, the *ERC* directed the *NREB* to submit a proposal regarding the review of *FiT* for wind technology beyond the original 200 *MW* installation target. The *NREB* proposed a Wind *FiT* of ₱8.49 per *kWh*. On July 30, 2015, the *ERC* conducted a public consultation on the new proposed Wind *FiT*. In a Decision dated October 6, 2015, the *ERC* set the Wind *FiT* at ₱7.40 per *kWh*. *MERALCO* filed a *MR* on the Decision. As at July 30, 2018, the *MR* is pending further action of the *ERC*.

On December 22, 2015, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2016. In an Order dated February 16, 2016, the *ERC* provisionally approved a *FiT-All* of ₱0.1240 per *kWh* effective in the succeeding billing period after *TransCo* received the Order. The *FiT-All* was implemented starting April 2016 billing month. In a Decision dated May 9, 2017, the *ERC* approved the final *FiT-All* for calendar year 2016 of ₱0.1830 per *kWh* effective in the succeeding billing period after *TransCo* received the Decision. The final *FiT-All* rate was implemented starting June 2017 billing.

On September 29, 2016, Alternergy Wind One Corporation, Petrowind Energy, Inc. and Trans-Asia Renewable Energy Corporation filed a Petition to Initiate Rule-Making to adjust the Wind *FIT* rate of ₱7.40 per *kWh* to ₱7.93 per *kWh*. *MERALCO* filed an intervention in the case. The hearing on the Petition was set on

January 6, 2017. *MERALCO*'s motion on the propriety of the petition has been submitted for the resolution of the *ERC*.

On December 1, 2016, *TransCo* filed for an application with the *ERC* seeking to collect a *FiT-All* rate of ₱0.2291 per *kWh* for 2017. In a Decision docketed May 11, 2018, the *ERC* approved the final *FiT-All* for calendar year 2017 of ₱0.2563 per *kWh* effective in the succeeding billing period after *TransCo* received the Decision. The final *FiT-All* rate was implemented starting June 2018 billing.

On August 30, 2017, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2018 seeking to collect a *FiT-All* rate of ₱0.2932 per *kWh*. As at July 30, 2018, the case has been submitted for decision of the *ERC*.

On July 27, 2018, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2019 seeking to collect a *FiT-All* rate of ₱0.2780 per *kWh*, effective January 2019 billing.

10. Recovery of National Power Corporation's ("*NPC") Stranded Contract Costs*

In an Order dated May 22, 2018, the *ERC* approved *PSALM*'s petition for the recovery of *NPC*'s stranded contract costs portion of the universal charge. Accordingly, *PSALM* is hereby authorized to recover the stranded contract costs for Luzon, Visayas and Mindanao grids totaling ₱8,547 million with a monthly rate of ₱0.1938 per *kWh* starting May 2018 billing period until the full amount has been recovered.

11. Net Metering Program

The *RE* Act mandates the *DU*s to provide the mechanism for the "physical connection and commercial arrangements necessary to ensure the success of the *RE* programs", specifically the Net Metering Program. The *RE* Act defines Net Metering as "a system, appropriate for distributed generation, in which a distribution grid user has a two-way connection to the grid and is only charged for his net electricity consumption and is credited for any overall contribution to the electricity grid". By their nature, net metering installations will be small (less than 100 *kW*) and will likely be adopted by households and small business end-users of *DU*s.

After consultations with stakeholders, the *ERC* issued on July 3, 2013 its Resolution No. 09, Series of 2013, entitled, "A Resolution Adopting the Rules enabling the Net Metering Program for Renewable Energy". The Rules will govern the *DUs*' implementation of the Net Metering Program. Included in the Rules are the interconnection standards that shall provide technical guidance to address engineering, electric system reliability, and safety concerns for net metering interconnections. The final pricing methodology, however, will be addressed in another set of rules and will be endorsed to the *ERC* in due course. In the meantime, the *DU*s' blended generation cost equivalent to the generation charge, shall be used as the preliminary reference price in the net metering agreement. The Rules took effect on July 24, 2013. As at June 30, 2018, *MERALCO* has already installed 1,451 meters and energized 1,340 net metering customers.

12. Interruptible Load Program *("ILP")*

In an *ERC* Order dated April 11, 2014, the *ERC* approved with modification *MERALCO*'s request that it be allowed to adopt and implement the *ILP*. *ILP* protocols, compensation and recovery mechanism are governed by *ERC* Resolution No. 5, Series of 2015 "A Resolution Adopting the Amended Rules to Govern the Interruptible Load Program" and *DOE* Circular No. DC2015-06-0003 "Providing the Interim Manner for Declaring Bilateral Contract Quantities in the Wholesale Electricity Spot Market and Directing the Philippine Electricity Market Corporation to Establish Necessary Protocols to Complement the Interruptible Load Program".

As at June 30, 2018, there are 153 companies with a total committed de-loading capacity of 576 *MW* that have signed up with *MERALCO*, *MPower* and with other retail electricity suppliers as *ILP* participants.

13. Long-term Indebtedness Application

On June 25, 2015, *MERALCO* filed an application, with prayer for provisional authority, for continuing authority to (a) issue bonds or other evidence of indebtedness for as long as it maintains 50:50 long-term debt to equity ratio; and (b) whenever necessary, to mortgage, pledge or encumber any of its property to any creditor in connection with its authority to issue bonds or any other evidence of long-term indebtedness. The hearing on the

application was conducted on October 6, 2015. In an Order dated October 12, 2015, the *ERC* directed *MERALCO* to submit additional documents in support of its application which *MERALCO* complied with. However, due to changes in the financial climate which may affect the terms and conditions of any financial borrowings, *MERALCO* has filed a Motion to Withdraw the application without prejudice to its refiling at a later date. In an Order dated March 22, 2016, the *ERC* granted *MERALCO*'s Motion to Withdraw but still required *MERALCO* to submit certain documents. *MERALCO* filed a Motion for Partial Reconsideration questioning the requirement which is pending before the *ERC*. As at July 30, 2018, the *ERC* has yet to resolve *MERALCO*'s Motion for Partial Reconsideration.

14. Prepaid Retail Electricity Service *("PRES")*

On December 12, 2014, *MERALCO* filed an application for authority to offer and provide *PRES* to its customers as well as the applicable rules to govern *PRES*. In a Decision dated April 27, 2015, the *ERC* approved the application with modification. As at June 30, 2018, there are 95,731 customers availing of *PRES*.

15. *CSP* for *PSA*s

As early as February 2013, the *ERC* posted the first draft of rules on *PSA* approval, solicited comments from stakeholders thereon and conducted various focused group discussions. Said draft required *DU*s to undergo *CSP* in their supply procurement, required a specific procedure for such and prescribed a *PSA* template.

Meanwhile, in October 2014, the *DOE* issued for comments its draft Circular on Demand Aggregation and Supply Auctioning Policy ("*DASAP*"). This was likewise subjected to public consultations.

In June 2015, *DOE* promulgated *DOE* Circular No. 2015-06-0008, "Providing Policies for Further Enhancement of the *WESM* Design and Operations", prescribing *DU*s to procure all its uncontracted demand through *CSP*, through the participation of a third party and which may be done by *DU*s on an aggregated basis. The *DOE* Circular gave *DOE* and *ERC* 120 days to issue the necessary Implementing Guidelines ("*IG*"). Instead of issuing an *IG*, in a Joint Resolution dated October 20, 2015, it was agreed by *DOE* and the *ERC* that the latter shall be the one to issue the relevant *CSP* regulations. On the same date, the *ERC* promulgated Resolution No. 13, Series of 2015.

ERC Resolution No. 13, Series of 2015 included the following provisions:

- All *DU*s are required to undergo *CSP*. Pending the *ERC*'s issuance of a prescribed process, *DU*s may adopt any accepted form of *CSP*, provided that the terms of reference shall include, among others, the following – (a) contract capacity or energy volume, (b) generation source, (c) method of fuel procurement, (d) contract period, (e) tariff structure, (f) Philippine peso or foreign currency denominated payment, (g) penalties, (h) applicable transmission projects, and (i) other key parameters.

- A *CSP* is successful if there are at least two (2) qualified bids. Should there be at least two (2) failed bids, then a *DU* can proceed with direct negotiation.

- The *CSP* requirement shall apply to *PSA*s that although executed, have not yet been filed for approval before the *ERC*.

On March 15, 2016, the *ERC* released Resolution No. 1, Series of 2016 entitled, "A Resolution Clarifying the Effectivity of *ERC* Resolution No. 13, Series of 2015". In this new Resolution, the *ERC* clarified that after judicious study and due consideration of views raised by different industry stakeholders, it has resolved that:

- The effectivity of *ERC* Resolution No. 13, Series of 2015 is hereby restated to be April 30, 2016.

- On the other forms of *CSP* referred to in Section 2 of the *ERC* Resolution No. 13, Series of 2015, these should likewise comply with the minimum terms of reference and the requirement of at least two (2) qualified bids for the *CSP* to be considered successful.

In reference to *PSA*s with provisions allowing the automatic renewal or extension of their term, *PSA*s that were previously approved by the *ERC* or filed with the *ERC* before the effectivity of this Resolution may have one (1) automatic renewal or extension for a period not exceeding one (1) year from the end of their respective terms.

Upon effectivity of this Resolution, automatic renewal clauses or extension of *PSA*s shall no longer be permitted.

On November 18, 2016, *MERALCO* received a copy of the Petition dated April 28, 2016 filed by a consumer group in the *SC* against the *ERC*, *DOE*, *MERALCO*, *Central Luzon Power*, *St. Raphael*, *PEDC*, *Mariveles Power*, *A1E*, *RP Energy* and the Philippine Competition Commission which sought to declare as void Resolution No. 1, Series of 2016 and to mandate the *ERC* to disapprove all *PSA* applications for failing to comply with the *CSP* requirement. In a Resolution dated November 16, 2016, the *SC* directed all parties to comment on the Petition. *MERALCO* has filed its comments to the Petition. In a Resolution dated June 17, 2017, the petitioners were directed to file their replies to the comments filed by respondents.

On February 9, 2018, the *DOE* published *DOE* Circular No. DC2018-02-0003, entitled, "Adopting and Prescribing the Policy for the Competitive Selection Process in the Procurement by Distribution Utilities of Power Supply Agreements for the Captive Market". Upon effectivity of the Circular, all prospective *PSA*s in grid and off-grid areas shall be procured through *CSP*.

The *CSP* under the Circular involves publication of invitation to bid, pre-bid conference, bid evaluation, and pre-/post-qualification of winning bidder. Exemption from *CSP* may be granted by the *DOE* in the following instances:

a. Generation project owned by the *DU* funded by grant or donations
b. Negotiated procurement of emergency supply
c. Provision of supply in off-grid areas prior to the entry of New Power Providers
d. Provision of supply by *PSALM* through bilateral contracts for power produced from undisposed generating assets and *IPP* contracts sanctioned by *EPIRA*

*PSA*s that were granted exemption from *CSP* shall be implemented by the *DU* immediately without prejudice to the evaluation and final decision of the *ERC*.

The *DU*'s *CSP* may be managed by a Third Party Bids and Awards Committee ("*TPBAC*") or a Third Party Administrator ("*TPA*"). Each *CSP* shall be completed within five (5) months from the time of the publication of the Invitation to Bid until submission of the *PSA* to the *ERC*.

Direct negotiations may be made by the *DU*s after at least two (2) failed *CSP*s and there is no outstanding dispute on the conducted *CSP*. A *CSP* is considered failed when during its conduct:

i. No proposal was received by the *DU*
ii. Only one (1) generator submitted an offer
iii. Competitive offers of prospective generators failed to meet the requirements prescribed in the bid document.

Within 60 days upon effectivity of the Circular, the *ERC* shall develop rules and procedures to:
(i) support the Circular, including guidelines for *TPA* accreditation and a *PSA* template, and
(ii) address disputes arising from the conduct of the *CSP*. On April 26, 2018, the *ERC* posted in its website the draft "Rules Governing the Execution, Review and Evaluation of Power Supply Agreements ("*PSA"*) Entered into by Distribution Utilities for the Supply of their Captive Market". *ERC* has conducted a public consultation and received comments thereon. As at July 30, 2018, *MERALCO* is awaiting the rules and procedures to be promulgated by the *ERC*.

OTHER QUANTITATIVE AND QUALITATIVE DISCLOSURES

(i) Any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in *MERALCO*'s liquidity increasing or decreasing in any material way.

Not applicable

(ii) Any events that will trigger direct or indirect contingent financial obligation that is material to *MERALCO*, including any default or acceleration of an obligation.

1. Mediation with *NPC*

The *NPC* embarked on a Power Development Program *("PDP")* which consisted of contracting generating capacities and the construction of its own, as well as private sector, generating plants, following a crippling power supply crisis. To address the concerns of the creditors of *NPC*, namely, Asian Development Bank and the World Bank, the *DOE* required *MERALCO* to enter into a long-term supply power contract with *NPC.*

Accordingly, on November 21, 1994, *MERALCO* entered into a 10-year *CSE* with *NPC* which commenced on January 1, 1995. The *CSE* and the rates and amounts charged to *MERALCO* therein were approved by the *BOD* of *NPC* and the then Energy Regulatory Board, respectively.

Separately, the *DOE* further asked *MERALCO* to provide a market for half of the output of the Camago-Malampaya gas field to enable its development and production of natural gas, which was to generate significant revenues for the Philippine Government and equally significant foreign exchange savings for the country to the extent of the fuel imports which the domestic volume of natural gas will displace.

MERALCO's actual purchases from *NPC* exceeded the contract level in the first seven (7) years of the *CSE*. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

While the events were beyond the control of *MERALCO*, *NPC* did not honor *MERALCO*'s good faith notification of its off-take volumes. A dispute ensued and both parties agreed to enter into mediation.

The mediation resulted in the signing of a Settlement Agreement (*SA)* between the parties on July 15, 2003. The *SA* was approved by the respective *BOD*s of *NPC* and *MERALCO*. The net settlement amount of ₱14,320 million was agreed upon by *NPC* and *MERALCO* and manifested before the *ERC* through a Joint Compliance dated January 19, 2006. The implementation of the *SA* is subject to the approval of *ERC*.

Subsequently, the *OSG* filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between *NPC* and *MERALCO*." As a result, *MERALCO* sought judicial clarification with the *RTC-Pasig*. Pre-trials were set, which *MERALCO* complied with and attended. However, the *OSG* refused to participate in the pre-trial and opted to seek a *TRO* from the *CA.*

In a Resolution dated December 1, 2010, the *CA* issued a *TRO* against the *RTC-Pasig*, *MERALCO* and *NPC* restraining the respondents from further proceeding with the case. Subsequently, in a Resolution dated February 3, 2011, the *CA* issued a *WPI* enjoining the *RTC-Pasig* from conducting further proceedings pending resolution of the Petition. In a Decision dated October 14, 2011, the *CA* resolved to deny the Petition filed by the *OSG* and lifted the injunction previously issued. The said Decision likewise held that the *RTC-Pasig* committed no error in finding the *OSG* in default due to its failure to participate in the proceedings. The *RTC-Pasig* was thus ordered to proceed to hear the case *ex-parte*, as against the *OSG*, and with dispatch. The *OSG* filed a *MR* which was denied by the *CA* in its Resolution dated April 25, 2012. The *OSG* filed a Petition for Review on Certiorari with the *SC*. *MERALCO'*s Comment was filed on October 29, 2012. Subsequently, a Decision dated December 11, 2013 was rendered by the First Division of the *SC* denying the Petition for Review on Certiorari by the *OSG* and affirming the decision promulgated by the *CA* on October 14, 2011.

With the dismissal of the petition filed by the *OSG* with the *CA*, *MERALCO* filed a motion for the reception of its evidence ex-parte with the *RTC-Pasig* pursuant to the ruling of the *CA*. In a Decision dated May 29, 2012, the *RTC-Pasig* declared the *SA*, independent of the pass-through for the settlement amount which is reserved for the *ERC*, valid and binding. The *OSG* has filed a Notice of Appeal with the *RTC-Pasig* on June 19, 2012. After both parties filed their respective appeal briefs, the *CA* rendered a Decision dated April 15, 2014 denying the appeal and affirming the *RTC-Pasig* Decision, which declared the *SA* as valid and binding. The *OSG* filed a Petition for Review with the *SC*. On November 10, 2014, *MERALCO* filed its comment to the Petition. In a Resolution dated July 8, 2015, the *SC* resolved to serve anew its Resolutions requiring *NPC* to comment on the Petition. In a Compliance, *NPC* submitted its Comment dated September 8, 2015. *MERALCO* submitted its Motion for Leave to File and to Admit Attached Reply on October 12, 2015. Pursuant to the *SC* Resolution dated November 11, 2015, the *OSG* filed a Consolidated

Reply to the comments filed by *NPC*, *MERALCO* and *PSALM*. *MERALCO* then filed a Motion for Leave to File and to Admit the Attached Rejoinder. As at April 30, 2018, *MERALCO* is awaiting further action of the *SC* on the matter. The *NPC* embarked on a Power Development Program ("*PDP*"), which consisted of contracting generating capacities and the construction of its own, as well as private sector, generating plants, following a crippling power supply crisis. To address the concerns of the creditors of *NPC*, namely, Asian Development Bank and the World Bank, the Department of Energy ("*DOE*") required that *MERALCO* enter into a long-term supply contract with the *NPC*.

Accordingly, on November 21, 1994, *MERALCO* entered into a 10-year Contract for Sale of Electricity ("*CSE*") with *NPC* to commence on January 1, 1995. The *CSE* and the rates and amounts charged to *MERALCO* therein, were approved by the *BOD* of *NPC* and the then Energy Regulatory Board, respectively.

Separately, the *DOE* further asked *MERALCO* to provide a market for half of the output of the Camago-Malampaya gas field to enable its development and production of natural gas, which was to generate significant revenues for the Philippine Government and equally significant foreign exchange savings for the country to the extent of the fuel imports, which the domestic volume of natural gas will displace.

MERALCO's actual purchases from *NPC* exceeded the contract level in the first seven (7) years of the *CSE*. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

While the events were beyond the control of *MERALCO*, *NPC* did not honor *MERALCO*'s good faith notification of its off-take volumes. A dispute ensued and both parties agreed to enter into mediation.

The mediation resulted in the signing of a Settlement Agreement ("*SA*") between the parties on July 15, 2003. The *SA* was approved by the respective *BOD*s of *NPC* and *MERALCO*. The net settlement amount of ₱14,320 million was agreed upon by *NPC* and *MERALCO* and manifested before the *ERC* through a Joint Compliance dated January 19, 2006. The implementation of the *SA* is subject to the approval of the *ERC*.

Subsequently, the *OSG* filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between *NPC* and *MERALCO*". As a result, *MERALCO* sought judicial clarification with the *RTC-Pasig*. Pre-trials were set, which *MERALCO* complied with and attended. However, the *OSG* refused to participate in the pre-trial and opted to seek a Temporary Restraining Order ("*TRO*") from the *CA*.

In a Resolution dated December 1, 2010, the *CA* issued a *TRO* against the *RTC-Pasig*, *MERALCO* and *NPC* restraining the respondents from further proceeding with the case. Subsequently, in a Resolution dated February 3, 2011, the *CA* issued a writ of preliminary injunction enjoining the *RTC-Pasig* from conducting further proceedings pending resolution of the Petition. In a Decision dated October 14, 2011, the *CA* resolved to deny the Petition filed by the *OSG* and lifted the injunction previously issued. The said Decision likewise held that the *RTC-Pasig* committed no error in finding the *OSG* in default due to its failure to participate in the proceedings. The *RTC-Pasig* was thus ordered to proceed to hear the case *ex-parte*, as against the *OSG*, and with dispatch. The *OSG* filed a *MR* which was denied by the *CA* in its Resolution dated April 25, 2012. The *OSG* filed a Petition for Review on Certiorari with the *SC*. *MERALCO*'s Comment was filed on October 29, 2012. Subsequently, a Decision dated December 11, 2013 was rendered by the First Division of the *SC* denying the Petition for Review on Certiorari by the *OSG* and affirming the Decision promulgated by the *CA* on October 14, 2011.

With the dismissal of the petition filed by the *OSG* with the *CA*, *MERALCO* filed a motion for the reception of its evidence *ex-parte* with the *RTC-Pasig* pursuant to the ruling of the *CA*. In a Decision dated May 29, 2012, the *RTC-Pasig* declared the *SA* valid and binding, independent of the pass-through for the settlement amount which is reserved for the *ERC*. The *OSG* has filed a Notice of Appeal with the *RTC-Pasig* on June 19, 2012. After both parties filed their respective appeal briefs, the *CA* rendered a Decision dated April 15, 2014 denying the appeal and affirming the *RTC* Decision, which declared the *SA* as valid and binding. The *OSG* filed a Petition for Review with the *SC*. On November 10, 2014, *MERALCO* filed its comment to the Petition. *PSALM* likewise filed its comment to the Petition. In a Resolution dated July 8, 2015, the *SC* resolved to serve anew its Resolutions requiring *NPC* to comment on the Petition. In compliance, *NPC* submitted its Comment dated September 8, 2015. *MERALCO* submitted its Motion for Leave to File and to Admit Attached Reply on October 12, 2015. Pursuant to the *SC* Resolution dated November 11, 2015, the *OSG* filed a Consolidated Reply to the comments filed by *NPC*, *MERALCO* and *PSALM*. *MERALCO* then filed a Motion for Leave to File and to Admit the Attached Rejoinder. The parties

have filed their respective memoranda. As at July 30, 2018, *MERALCO* is awaiting further action of the *SC* on the matter.

2. Sucat-Araneta-Balintawak Transmission Line

The Sucat-Araneta-Balintawak transmission line is a two-part transmission line, which completed the 230 *kV* line loop within Metro Manila. The two main parts are the Araneta to Balintawak leg and the Sucat to Araneta leg, which cuts through Dasmariñas Village, Makati City.

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City "the *Plaintiffs*", filed a case against *NPC* with the *RTC-Makati*, enjoining *NPC* from further installing high voltage cables near the *Plaintiffs*' homes and from energizing and transmitting high voltage electric current through said cables because of the alleged health risks and danger posed by the same through the electromagnetic field emitted by said lines. Following its initial status quo Order issued on March 13, 2000, *RTC-Makati* granted on April 3, 2000 the preliminary injunction sought by the *Plaintiffs*. The decision was affirmed by the *SC* on March 23, 2006, which effectively reversed the decision of the *CA* to the contrary. The *RTC-Makati* subsequently issued a writ of execution based on the Order of the *SC*. *MERALCO*, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230 *kV* line will result in widespread and rotating brownouts within *MERALCO*'s franchise area with certain power plants unable to run at their full capacities.

On September 8, 2009, the *RTC-Makati* granted the motions for intervention filed by intervenors *MERALCO* and *NGCP* and dissolved the Writ of Preliminary Injunction issued, upon the posting of the respective counter bonds by defendant *NPC*, intervenors *MERALCO* and *NGCP*, subject to the condition that *NPC* and intervenors will pay for all damages, which the *Plaintiffs* may incur as a result of the Writ of Preliminary Injunction.

In its Order dated February 5, 2013, the *RTC-Makati* granted the *Plaintiffs*' motion and directed the re-raffle of the case to another branch after the judicial dispute resolution failed.

This case remains pending and is still at the pre-trial stage. During the pre-trial stage, the *Plaintiffs* filed a Manifestation stating that they are pursuing the deposition of a supposed expert in electromagnetic field through oral examination without leave of court in late January or early February 2016 or on such date as all the parties may agree amongst themselves at the Consulate Office of the Philippines in Vancouver, Canada. *NPC* and intervenors filed their Opposition and Counter-Manifestation. Intervenor *NGCP* filed a Motion to Prohibit the Taking of the Deposition of the said expert. Intervenor *MERALCO* intends to file its Comment/Opposition in due course. As at July 30, 2018, *MERALCO* is awaiting further action of the *SC* on the matter.

3. *RPT* Assessment

Several Local Government Units ("*LGU*s") assessed *MERALCO* for deficiency *RPT* on certain assets. The assets include electric transformers, distribution wires, insulators, and poles, collectively referred to as *TWIP*. Of these *LGU*s, one (1) has secured a favorable decision from the *CA*. Such decision was appealed by *MERALCO* to the *SC* for the benefit of *MERALCO* customers. On October 22, 2015, *MERALCO* received a copy of the *SC* Decision promulgated on August 5, 2015 declaring, among others, that the transformers, electric posts, transmission lines, insulators, and electric meters of *MERALCO* are not exempted from *RPT* under the *LGC*. *MERALCO* did not appeal the *SC* Decision. The cases of the other *LGU*s are pending with their respective administrative bodies or government offices.

In 2016, *MERALCO* began the process of settlement with the affected *LGU*s. *MERALCO* has filed for the recovery of the resulting *RPT* payments to certain *LGU*'s from customers in the relevant areas with the *ERC* and will file for similar recovery for succeeding payments.

On January 30, 2017, *PEPOA* filed a Petition for rule-making proposing that *RPT* be allowed as a pass-through cost in the light of the *SC* Decision. Hearings have been completed and *MERALCO* filed its intervention and submitted its comments. As at July 30, 2018, the Petition is pending before the *ERC*.

4. *LFT* Assessments of Municipalities

Certain municipalities have served assessment notices on *MERALCO* for *LFT*. As provided in the Local Government Code ("*LGC*"), only cities and provincial governments may impose taxes on establishments doing business in their localities. On the basis of the foregoing, *MERALCO* and its legal counsel believe that *MERALCO* is not subject or liable for such assessments.

5. *SC* Decision on Unbundling Rate Case

On May 30, 2003, the *ERC* issued an Order approving *MERALCO*'s unbundled tariffs that resulted in a total increase of ₱0.17 per *kWh* over the May 2003 tariff levels. However, on August 4, 2003, *MERALCO* received a Petition for Review of the *ERC*'s ruling filed by certain consumer and civil society groups before the Court of Appeals ("*CA*"). On July 22, 2004, the *CA* set aside the *ERC*'s ruling on *MERALCO*'s rate unbundling and remanded the case to the *ERC*. Further, the *CA* opined that the *ERC* should have asked the Commission on Audit ("*COA*") to audit the books of *MERALCO*. The *ERC* and *MERALCO* subsequently filed separate motions asking the *CA* to reconsider its decision. As a result of the denial by the *CA* of the motions on January 24, 2005, the *ERC* and *MERALCO* elevated the case to the *SC*.

In an En Banc decision promulgated on December 6, 2006, the *SC* set aside and reversed the *CA* ruling saying that a *COA* audit was not a prerequisite in the determination of a utility's rates. However, while the *SC* affirmed *ERC*'s authority in rate-fixing, the *SC* directed the *ERC* to request *COA*'s assistance to undertake a complete audit of the books, records and accounts of *MERALCO*. In compliance with the directive of the *SC*, the *ERC* requested *COA* to conduct an audit of the books, records and accounts of *MERALCO* using calendar years 2004 and 2007 as test years.

The *COA* audit, which began in September 2008, was completed with the submission to the *ERC* of its report on November 12, 2009.

On February 15, 2010, the *ERC* issued its Order directing *MERALCO* and all intervenors in the case to submit, within 15 days from receipt of the Order, their respective comments on the *COA* report.

On June 21, 2011, the *ERC* maintained and affirmed its findings and conclusions in its Decision dated March 20, 2003 and Order dated May 30, 2003. The *ERC* stated that the *COA* recommendation to apply disallowances under *PBR* to rate unbundling violates the principle against retroactive rate-making. An intervenor group filed a *MR* of the said Order. On September 5, 2011, *MERALCO* filed its comment on the intervenor's *MR*. On February 4, 2013, the *ERC* denied the intervenor's *MR*. The intervenor filed a Petition for Review before the *CA* and *MERALCO* filed its comment thereon on May 29, 2014. In compliance with the *CA*'s directive, *MERALCO* filed its Memorandum in August 2015. In a Resolution dated September 29, 2015, the *CA* acknowledged receipt of the respective memoranda from parties and declared the case submitted for decision. In a Decision dated February 29, 2016, the *CA* dismissed the Petition for Review and affirmed the orders dated June 21, 2011 and February 4, 2013 of the *ERC*.

On March 22, 2016, the intervenors filed a *MR* on the *CA* Decision dated February 29, 2016. The same was denied by the *CA* through a Resolution dated August 8, 2016.

On October 11, 2016, *MERALCO* received a Petition for Review on Certiorari filed by the intervenors before the *SC* appealing the dismissal of its Petition. *MERALCO*, *COA* and the *ERC* have filed their respective comments to the Petition. On June 22, 2017, *MERALCO* received the Motion for Leave to Intervene and Admit Comment-in-Intervention filed by other *DU*s that sought to intervene in the case. In a Resolution dated July 11, 2017, the *SC* required the parties to comment on the Motion for Leave to Intervene and Comment-in-Intervention. The intervenors filed their Comments dated September 19, 2017. *MERALCO* filed its Comments on October 18, 2017. On October 27, 2017, *COA* filed its Comments to the Motion for Leave to Intervene and Admit Comment-in-Intervention. As at July 30, 2018, further action of the *SC* on the matter is pending.

(iii) All material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of *MERALCO* with unconsolidated entities or other persons created during the reporting period.

2018 Capital Expenditure Requirements (*in millions*)	
Electric capital projects	₱13,232
Non-electric projects and other capitalized items	8,055
Total capital expenditures	₱21,287

MERALCO has a management-approved capital expenditure budget of ₱21,287 million for the year ending December 31, 2018, of which about 62% represents planned expenditures for the electric capital projects of the power distribution business. The capital expenditure budget shall address requirements in areas with large concentration of core customers, correct normal deficiencies in the system, stretch loading limits of *MERALCO* facilities and initiate practical and cost-effective projects to correct system deficiencies.

Absent the release by the *ERC* of the final rules to govern the filing of its 4th *RP* reset, *MERALCO* filed on February 9, 2015 an application for approval of authority to implement its *CAPEX* program for *RY* 2016 (July 1, 2015 to June 30, 2016) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act. On June 15, 2016, *MERALCO* received a copy of the *ERC* Decision dated April 12, 2016 which partially approved *MERALCO*'s *CAPEX* program for *RY* 2016 amounting to ₱15.5 billion out of the total *RY* 2016 *CAPEX* of ₱17.7 billion, subject to certain conditions. An intervenor has filed a *MR* on the Decision which is pending before the *ERC*. On July 25, 2016, *MERALCO* filed its opposition to the *MR*. As at July 30, 2018, the *ERC* ruling on the *MR*s is pending.

On March 8, 2016, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program for *RY* 2017 (July 1, 2016 to June 30, 2017) pursuant to the Public Service Act. On July 26, 2016, *MERALCO* received the Order dated May 5, 2016, which partially approved *MERALCO*'s *CAPEX* program for *RY* 2017 amounting to ₱8.8 billion out of the total *RY* 2017 *CAPEX* of ₱15.4 billion, subject to certain conditions. On August 10, 2016, *MERALCO* filed a Motion for Partial Reconsideration on the requirement to submit an accounting of the depreciation fund. Hearings on the application have been completed. On September 14, 2016, *MERALCO* filed a Motion for Resolution. Subsequently, on April 25, 2017, *MERALCO* filed a Very Urgent Motion for Resolution of the application. Thereafter, on October 18, 2017, *MERALCO* filed a Manifestation and Urgent Motion for Resolution. On November 9, 2017, *MERALCO* filed a Manifestation with Third Urgent Motion to Resolve the Application. As at July 30, 2018, *MERALCO* is awaiting the final decision of the *ERC*.

On April 3, 2017, *MERALCO* filed an application for approval of authority to implement its ₱18.8 billion *CAPEX* program for *RY* 2018 (July 1, 2017 to June 30, 2018) pursuant to the Public Service Act. On May 26, 2017, *MERALCO* received the Order dated May 15, 2017, which set the case for initial hearing. Hearings were conducted on June 22 and August 1, 2017, August 25, 2017 and September 22, 2017. A conference was also conducted with the *ERC* technical staff and the intervenor on October 12, 2017. On November 9, 2017, *MERALCO* filed its *FOE*. *MERALCO* also filed Manifestations on November 9, 2017 and March 28, 2018, informing the *ERC* that it was constrained to implement several projects in order to avert service interruptions to its customers and maintain a robust distribution infrastructure. As at July 30, 2018, the case has been submitted for decision.

On April 30, 2018, *MERALCO* filed an application for approval of authority to implement its ₱21 billion *CAPEX* program for *RY* 2019 (July 1, 2018 to June 30, 2019) pursuant to the Public Service Act. On July 9, 2018, *MERALCO* filed a Very Urgent Motion for Issuance of Provisional Authority and to set case for initial hearing. As at July 30, 2018, *MERALCO* is awaiting further action of the *ERC*.

(iv) Any known trends, events or uncertainties that have had or that are reasonably expected to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations should be described.

1. Retail Competition

See related preceding discussions under *RCOA*.

2. Petition for Dispute Resolution against *PEMC*, *TransCo*, *NPC* and *PSALM*

On September 9, 2008, *MERALCO* filed a Petition for Dispute Resolution, against *PEMC*, *TransCo*, *NPC* and *PSALM* with the *ERC* as a result of the congestion in the transmission system of *TransCo* arising from the outages of the San Jose-Tayabas 500 *kV* Line 2 on June 22, 2008, and the 500 *kV* 600 Mega Volt-Ampere Transformer Bank No. 2 of *TransCo*'s San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct *PEMC* to adopt the *NPC*- Time-of-Use ("*TOU*") rate or the new price determined through the price substitution methodology of *PEMC* as approved by the *ERC*, as basis for its billing during the period of the congestion and direct *NPC* and *PSALM* to refund the transmission line loss components of the line rentals associated with *NPC/PSALM* bilateral transactions from the start of *WESM* operation on June 26, 2006.

In a Decision dated March 10, 2010, the *ERC* granted *MERALCO*'s petition and ruled that there is double charging of the transmission line costs billed to *MERALCO* by *NPC* for the Transition Supply Contract ("*TSC*") quantities to the extent of 2.98% loss factor, since the effectivity of the *TSC* in November 2006. Thus, *NPC* was directed to refund line rental adjustment to *MERALCO*. In the meantime, the *ERC* issued an Order on May 4, 2011 allowing *PEMC* to submit an alternative methodology for the segregation of line rental into congestion cost and line losses from the start of the *WESM*. *PEMC* has filed its compliance submitting its alternative methodology.

On September 8, 2011, *MERALCO* received a copy of *PEMC*'s compliance to the *ERC*'s directive and on November 11, 2011, *MERALCO* filed a counter-proposal which effectively simplifies *PEMC*'s proposal.

In an Order of the *ERC* dated June 21, 2012, *MERALCO* was directed to submit its computation of the amount of the double charging of line loss on a per month basis from June 26, 2006 up to June 2012. On July 4, 2012, *MERALCO* filed its Compliance to the said Order. Thereafter, the *ERC* issued an Order directing the parties to comment on *MERALCO*'s submissions. Hearings were conducted on October 2, 2012 and October 16, 2012 to discuss the parties' proposal and comments.

In an Order dated March 4, 2013, the *ERC* approved the methodology proposed by *MERALCO* and *PEMC* in computing the double charged amount on line losses by deducting 2.98% from the *NPC-TOU* amount. Accordingly, the *ERC* determined that the computed double charge amount to be collected from *NPC* is ₱5.2 billion, covering the period November 2006 to August 2012 until actual cessation of the collection of the 2.98% line loss charge in the *NPC-TOU* rates imposed on *MERALCO*. In this regard, *NPC* was directed by the *ERC* to refund said amount by remitting to *MERALCO* the equivalent amount of ₱73.9 million per month until the over-recoveries are fully refunded. In the said Order, the *ERC* likewise determined that the amount to be collected from the successor generating companies ("*SGC*s") is ₱4.7 billion. Additionally, *MERALCO* was directed to file a petition against the following *SGC*s: *MPPCL*, Aboitiz Power Renewables, Inc. ("*APRI*"), *TLI*, *SMEC* and *Sem-Calaca*, within 30 days from receipt thereof, to recover the line loss collected by them. On April 19, 2013, *MERALCO* filed a Motion for Clarification with the *ERC* regarding the directives contained in the March 4, 2013 Order. On April 30, 2013 and May 8, 2013, *PSALM* and *NPC*, respectively, filed motions seeking reconsideration of the March 4, 2013 Order. *MERALCO* filed a motion seeking for an additional 15 days from its receipt of the *ERC*'s Order resolving its Motion for Clarification, within which to file its Petition against the *SGC*s.

In an Order dated July 1, 2013, the *ERC* issued the following clarifications/resolutions: (i) *SPPC* should be included as one of the *SGC*s against whom a petition for dispute resolution should be filed by *MERALCO*; (ii) Amount to be refunded by *NPC* is not only ₱5.2 billion but also the subsequent payments it received from *MERALCO* beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates; (iii) Petition to be filed by *MERALCO* against the *SGC*s should not only be for the recovery of the

amount of ₱4.7 billion but also the subsequent payments beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates; (iv) "SCPC Ilijan" pertains to *SPPC* instead. Thus, the refundable amount of ₱706 million pertaining to "SCPC Ilijan" should be added to *SPPC*'s refundable amount of ₱1.1 billion; (v) Grant the Motion for Extension filed by *MERALCO* within which to file a petition against the following *SGC*s: *MPPCL, APRI, TLI, SMEC, Sem-Calaca* and *SPPC*; and (vi) deny the respective *MR*s filed by *NPC* and *PSALM*.

On September 12, 2013, *MERALCO* filed a Manifestation with Motion with the *ERC* seeking approval of its proposal to offset the amount of ₱73.9 million per month against its monthly remittances to *PSALM*. *PSALM* and *NPC* filed their comments *Ad Cautelam* and Comment and Opposition *Ad Cautelam*, respectively, on *MERALCO*'s Manifestation and Motion. On November 4, 2013, *MERALCO* filed its reply. As at July 30, 2018, *MERALCO*'s Manifestation and Motion is pending resolution by the *ERC*.

On October 24, 2013, *MERALCO* received *PSALM*'s Petition for Review on Certiorari with the *CA* (With Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction Applications) questioning the March 4, 2013 and July 1, 2013 Orders of the *ERC*.

On February 3, 2014, *MERALCO* filed a Comment with Opposition to the Application for *TRO* or Writ of Preliminary Injunction dated January 30, 2014. *PEMC* filed a Comment and Opposition Re: Petition for Certiorari with Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction dated January 6, 2014. On June 4, 2014, the *CA* issued a Resolution declaring that *PSALM* is deemed to have waived the filing of a Reply to the comment and opposition of *MERALCO* and *PEMC* and directing the parties to submit their simultaneous memoranda within 15 days from notice. On December 1, 2014, the *CA* issued a decision dismissing the Petition for Certiorari filed by *PSALM* against the *ERC*, *MERALCO* and *PEMC* and affirming the *ERC*'s ruling on the refund of the ₱5.2 billion of transmission line losses double charged by *PSALM* and *NPC*. On January 30, 2015, *PSALM* filed its *MR* on the December 1, 2014 Decision of the *CA*. *MERALCO* has filed its Opposition to the *MR*. In a Resolution dated August 11, 2015, the *CA* denied *PSALM*'s *MR*. On October 27, 2015, *MERALCO* received *PSALM*'s Petition for Review with the *SC*. The Petition has been given due course and the parties have filed their respective memoranda. As at July 30, 2018, *MERALCO* is still awaiting further action of the *SC* on the Petition.

3. *Petition for Dispute Resolution Against SPPC, MPPCL, APRI, TLI, SMEC and Sem-Calaca*

On August 29, 2013, *MERALCO* filed a Petition for Dispute Resolution against *SPPC*, *MPPCL*, *APRI*, *TLI*, *SMEC* and *Sem-Calaca.* Said Petition seeks the following: 1) refund of the 2.98% transmission line losses in the amount of ₱5.4 billion, inclusive of the ₱758 million line loss for the period September 2012 to June 25, 2013, from said *SGC*s; and 2) approval of *MERALCO*'s proposal to correspondingly refund to its customers the aforementioned line loss amounts, as and when the same are received from the *SGC*s, until such time that the said over-recoveries are fully refunded, by way of automatic deduction of the amount of refund from the computed monthly generation rate. On September 20, 2013, *MERALCO* received the *SGC*s' Joint Motion to Dismiss. On October 7, 2013, *MERALCO* filed its Comment on the said Joint Motion.

On October 8, 2013, *MERALCO* received the *SGC*s Manifestation and Motion, which sought, among other things, the cancellation of the scheduled initial hearing of the case, including the submission of the parties respective Pre-trial Briefs, until the final resolution of the *SGC*'s Joint Motion to Dismiss. On October 11, 2013, *MERALCO* filed its pre-trial brief. On October 14, 2013, *MERALCO* filed its Opposition to the *SGC*'s Manifestation and Motion. On October 24, 2013, *MERALCO* received the *SGC'*s Reply to its Comment on the Joint Motion to Dismiss. On October 29, 2013, *MERALCO* filed its Rejoinder. Thereafter, the *SGC*'s filed their Sur-Rejoinder dated November 4, 2013. As at July 30, 2018, the Joint Motion to Dismiss is pending resolution by the *ERC*.

4. *PSALM* versus *PEMC* and *MERALCO*

Due to the significant increases in *WESM* prices during the 3rd and 4th months of the *WESM* operations, *MERALCO* raised its concerns with the *PEMC* with request for the latter to investigate whether *WESM* rules were breached or if anti-competitive behavior had occurred.

While resolutions were initially issued by the *PEMC* directing adjustments of *WESM* settlement amounts, a series of exchanges and appeals with the *ERC* ensued. *ERC* released an order directing that the *WESM*

settlement price for the 3rd and 4th billing months be set at *NPC-TOU* rates, prompting *PSALM* to file a Motion for Partial Reconsideration, which was denied by the *ERC* in an Order dated October 20, 2008. *PSALM* filed a Petition for Review before the *CA*, which was dismissed on August 28, 2009, prompting *PSALM* to file an *MR*, which was likewise denied by the *CA* on November 6, 2009. In December 2009, *PSALM* filed a Petition for Review on Certiorari with the *SC*. *MERALCO* has filed its comments on the Petition and its Memorandum. As at July 30, 2018, *PSALM*'s Petition for Review is pending resolution by the *SC*.

5. Petition for Dispute Resolution with *NPC* on Premium Charges

On June 2, 2009, *MERALCO* filed a Petition for Dispute Resolution against *NPC* and *PSALM* with respect to *NPC*'s imposition of premium charges for the alleged excess energy it supplied to *MERALCO* covering the billing periods May 2005 to June 2006. The premium charges amounting to ₱315 million during the May-June 2005 billing periods have been paid but are the subject of a protest by *MERALCO*, and premium charges of ₱318 million during the November 2005, February 2006 and April to June 2006 billing periods are being disputed and withheld by *MERALCO*. *MERALCO* believes that there is no basis for the imposition of the premium charges. The hearings on this case have been completed. As at July 30, 2018, the petition is pending resolution by the *ERC*.

6. *SC TRO* on *MERALCO*'s December 2013 Billing Rate Increase

On December 9, 2013, the *ERC* gave clearance to the request of *MERALCO* to implement a staggered collection over three (3) months covering the December 2013 billing month for the increase in generation charge and other bill components such as *VAT*, *LFT*, transmission charge, and *SL* charge. The generation costs for the November 2013 supply month increased significantly because of the aberrant spike in the *WESM* charges on account of the non-compliance with *WESM* Rules by certain plants resulting in significant power generation capacities not being offered and dispatched, and the scheduled and extended shutdowns, and the forced outages, of several base load power plants, and the use of the more expensive liquid fuel or bio-diesel by the natural gas-fired power plants that were affected by the Malampaya Gas Field, shutdown from November 11 to December 10, 2013.

On December 19, 2013, several party-list representatives of the House of Representatives filed a Petition against *MERALCO*, *ERC* and *DOE* before the *SC*, questioning the *ERC* clearance granted to *MERALCO* to charge the resulting price increase, alleging the lack of hearing and due process. It also sought for the declaration of the unconstitutionality of the *EPIRA*, which essentially declared the generation and supply sectors competitive and open, and not considered public utilities. A similar petition was filed by a consumer group and several private homeowners associations challenging also the legality of the *AGRA* that the *ERC* had promulgated. Both petitions prayed for the issuance of *TRO*, and a Writ of Preliminary Injunction.

On December 23, 2013, the *SC* consolidated the two (2) Petitions and granted the application for *TRO* effective immediately and for a period of 60 days, which effectively enjoined the *ERC* and *MERALCO* from implementing the price increase. The *SC* also ordered *MERALCO*, *ERC* and *DOE* to file their respective comments to the Petitions. Oral Arguments were conducted on January 21, 2014, February 4, 2014 and February 11, 2014. Thereafter, the *SC* ordered all the Parties to the consolidated Petitions to file their respective Memorandum on or before February 26, 2014 after which the Petitions will be deemed submitted for resolution of the *SC*. *MERALCO* complied with said directive and filed its Memorandum on said date.

On February 18, 2014, acting on the motion filed by the Petitioners, the *SC* extended for another 60 days or until April 22, 2014, the *TRO* that it originally issued against *MERALCO* and *ERC* last December 23, 2013. The *TRO* was also similarly applied to the generating companies, specifically *MPPCL*, *SMEC*, *SPPC*, *FGPC*, and the *NGCP*, and the *PEMC* (the administrator of *WESM* and market operator) who were all enjoined from collecting from *MERALCO* the deferred amounts representing the ₱4.15 per *kWh* price increase for the November 2013 supply month.

In the meantime, on January 30, 2014, *MERALCO* filed an Omnibus Motion with Manifestation with the *ERC* for the latter to direct *PEMC* to conduct a re-run or re-calculation of the *WESM* prices for the supply months of November to December 2013. Subsequently, on February 17, 2014, *MERALCO* filed with the *ERC* an

Application for the recovery of deferred generation costs for the December 2013 supply month praying that it be allowed to recover the same over a six-month period.

On March 3, 2014, the *ERC* issued an Order voiding the Luzon *WESM* prices during the November and December 2013 supply months on the basis of the preliminary findings of its Investigating Unit ("*IU*") that these are not reasonable, rational and competitive, and imposing the use of regulated rates for the said period. *PEMC* was given seven (7) days upon receipt of the Order to calculate these regulated prices and implement the same in the revised *WESM* bills of the concerned *DU*s in Luzon. *PEMC*'s recalculated power bills for the supply month of December 2013 resulted in a net reduction of the December 2013 supply month bill of the *WESM* by ₱9.3 billion. Due to the pendency of the *TRO*, no adjustment was made to the *WESM* bill of *MERALCO* for the November 2013 supply month. The timing of amounts to be credited to *MERALCO* is dependent on the reimbursement of *PEMC* from associated generator companies. However, several generating companies, including *MPPCL*, SN Aboitiz Power, Inc., Team Energy, PanAsia Energy, Inc. ("*PanAsia*"), and *SMEC*, have filed *MR*s questioning the Order dated March 3, 2014. *MERALCO* has filed a consolidated comment to these *MR*s. In an Order dated October 15, 2014, the *ERC* denied the *MR*s. The generating companies have appealed the Orders with the *CA*. *MERALCO* has filed a motion to intervene and a comment in intervention. The *CA* consolidated the cases filed by the generation companies. In a Decision dated November 7, 2017, the *CA* set aside *ERC* Orders dated March 3, 2014, March 27, 2014, May 9, 2014 and October 15, 2014 and declared the orders null and void. The Decision then reinstated and declared valid *WESM* prices for the November and December 2013 supply months. *MERALCO* and the *ERC* have filed their respective motions for reconsideration. Several consumers also intervened in the case and filed their respective motions for reconsideration. The *CA* has yet to resolve the motions for reconsideration filed by *MERALCO* and *ERC*.

In view of the pendency of the various submissions before the *ERC* and mindful of the complexities in the implementation of the *ERC*'s Order dated March 3, 2014, the *ERC* directed *PEMC* to provide the market participants an additional period of 45 days to comply with the settlement of their respective adjusted *WESM* bills. In an Order dated May 9, 2014, the parties were then given an additional non-extendible period of 30 days from receipt of the Order within which to settle their *WESM* bills. However, in an Order dated June 6, 2014 and acting on an intervention filed by Angeles Electric Corporation, the *ERC* deemed it appropriate to hold in abeyance the settlement of *PEMC*'s adjusted *WESM* bills by the market participants.

On April 22, 2014, the *SC* extended indefinitely the *TRO* issued on December 23, 2013 and February 18, 2014 and directed generating companies, *NGCP* and *PEMC* not to collect from *MERALCO*. As at July 30, 2018, the *SC* has yet to resolve the various petitions filed against *MERALCO*, *ERC*, and *DOE*.

7. *ERC* Investigating Unit *("IU*") Complaint

On December 26, 2013, the *ERC* constituted the *IU* under its Competition Rules to investigate possible anti-competitive behavior by the industry players and possible collusion that transpired in the *WESM* during the supply months of November 2013 and December 2013. *MERALCO* participated in the proceedings and submitted a Memorandum.

An investigating officer of the *IU* filed a Complaint dated May 9, 2015 against *MERALCO* and *TMO* for alleged anti-competitive behavior constituting economic withholding in violation of Section 45 of the *EPIRA* and Rule 11, Section 1 and 8(e) of the *EPIRA IRR*. In an Order dated June 15, 2015 the *ERC* directed *MERALCO* to file its comment on the Complaint. *MERALCO* and *TMO* have filed their respective answers to the Complaint.

In an Order dated September 1, 2015, the *ERC* directed the investigating officer to file his reply to *MERALCO*. In a Manifestation and Motion to Set the Case for Hearing dated November 9, 2015, the investigating officer manifested that he would no longer file a reply and that the case be set for hearing.

On May 24, 2016, the *ERC* promulgated Resolution No. 14, Series of 2016, which resolved to divide the Commission into two (2) core groups for the conduct of hearings and to designate the commissioners to act as presiding officers in anti-competition cases. The raffle pursuant to said Resolution was conducted on June 15, 2016.

In a Notice of Pre-Trial Conference dated June 16, 2016, the *ERC* set the pre-trial conference on August 18, 2016 and required *MERALCO* and *TMO* to submit their respective pre-trial briefs. However, on July 27, 2016, the complainant filed two (2) omnibus motions for the consolidation and deferment of the pre-

trial conferences. Hence, in an Order dated August 1, 2016, the respondents were given 10 days to submit their comments on the Motion for Consolidation, with the complainant given five (5) days to file his reply. As such, the pre-trial conferences as scheduled were deferred until further notice and all parties were granted 20 days to submit their respective pre-trial briefs.

In the meantime, *MERALCO* likewise filed an Urgent Motion to Dismiss with Motion to Suspend Proceedings which was adopted by *TMO* in its Manifestation and Motion filed on July 28, 2016. *MERALCO* maintained that the Complaint should be dismissed due to the absence of subject matter jurisdiction as it is now the Philippine Competition Commission ("*PCC*") which has original and primary jurisdiction over competition-related cases in the energy sector. On August 23, 2016, *MERALCO* filed an Urgent Motion Ad Cautelam for suspension of proceeding including period to file pre-trial brief and judicial affidavit.

In a Motion dated August 25, 2016, complainant filed a Motion to defer the submission of the complainant's pre-trial brief and judicial affidavit. In an Order dated June 13, 2017, the *ERC* denied the motion to consolidate but upheld the authority of private counsel to represent the complainants. *MERALCO* filed a Motion for Partial Reconsideration to question such authority.

In an Order dated February 2, 2017, the *ERC* denied the motion to dismiss and asserted jurisdiction over the Complaint. *MERALCO* filed its *MR* to the Order on February 23, 2017. In an Order dated June 20, 2017, the *ERC* denied the *MR*. On September 19, 2017, *MERALCO* filed a Petition for Certiorari with the *CA*. In a Resolution dated October 2, 2017, the *CA* required respondents to file their Comment on the Petition within 10 days and held in abeyance its resolution on the prayer for injunctive relief until the comments have been filed. *MERALCO* was likewise given five (5) days to file its reply. In a Manifestation dated October 23, 2017, the *ERC* stated that it is a nominal party in the case as the quasi-judicial tribune that issued the assailed ordinances. The *IU* filed its own Comment dated December 19, 2017. In a Manifestation and Motion dated December 22, 2017, the *OSG* informed the *CA* that it will no longer represent the *IU* and will instead participate as "tribune of the people". In the meantime, *TMO* also filed a separate Petition for Review on Certiorari with the *CA*. In a Resolution dated January 10, 2018, the *CA* ordered the consolidation of the petitions of *TMO* and *MERALCO*. In a Decision dated May 23, 2018, the *CA* denied the consolidated Petitions filed by *MERALCO*, *TMO*, and *APRI*, and ruled that the jurisdiction to resolve the *IU* cases remains with the *ERC* because the Philippine Competition Act ("*PCA*") does not apply retroactively.

On June 20, 2018, *MERALCO* filed an *MR* with the *CA*. The *ERC* likewise filed its Motion for Partial Reconsideration on the ground that it retained concurrent jurisdiction together with the *PCC* over cases involving alleged anti-competitive conduct supposedly because the *PCA* did not repeal Section 45 of the *EPIRA*. In a Resolution dated July 3, 2018, *MERALCO* was directed to file its comment to the *ERC*'s Motion for Partial Reconsideration. *MERALCO* is currently preparing its Comment to the Motion for Partial Reconsideration of the *ERC*.

8. *SPPC* vs. *PSALM*

SPPC and *PSALM* are parties to an Independent Power Producer Administration ("*IPPA*") Agreement covering the Ilijan Power Plant. On the other hand, *MERALCO* and *SPPC* have a *PSA* covering the sale of electricity from the Ilijan Power Plant to *MERALCO*. In a letter dated September 8, 2015, *SPPC* informed *MERALCO* that due to an ongoing dispute with *PSALM* arising from difference in interpretation of the provisions of the *IPPA* Agreement, the latter terminated the said Agreement. *SPPC* filed a complaint at *RTC*-Mandaluyong to nullify the termination notice for lack of factual and legal basis. On said date, the executive judge of the *RTC*-Mandaluyong issued a 72-hour *TRO*. In an Order dated September 11, 2015, the *RTC*-Mandaluyong extended the *TRO* by an additional 17 days. In an Order dated September 28, 2015, the *RTC*-Mandaluyong granted the prayer for preliminary injunction. *PSALM* has filed *MR*s to question the Orders.

MERALCO filed a Motion for Leave to Intervene with Motion to Admit Attached Complaint-in-Intervention. In an Order dated October 19, 2015, the *RTC*-Mandaluyong allowed *MERALCO*'s intervention in the proceedings and admitted its Complaint-in-Intervention. *PSALM* filed a *MR* dated November 6, 2015 of the Order admitting *MERALCO*'s intervention. *RTC*-Mandaluyong issued an Order dated June 27, 2016 denying the *MR*s. *PSALM* has elevated these orders to the *CA* through a Petition for Certiorari. In a Resolution dated May 25, 2017, the *CA* denied *PSALM*'s prayer for the issuance of a *TRO* and/or writ of preliminary injunction. In a Decision dated December 19, 2017, the *CA* dismissed the Petition and affirmed the orders of the *RTC*-Mandaluyong. As at July 30, 2018, hearings are ongoing before the new presiding judge.

9. Ombudsman Cases Against Directors

On January 30, 2018, *MERALCO* received an Order dated January 22, 2018 from the Office of the Ombudsman directing *MERALCO*'s directors to comment on a complaint-affidavit for syndicated estafa filed by a consumer group which charged that there was conspiracy between *MERALCO* directors and the *ERC* regarding the alleged misappropriation of the bill deposits received from *MERALCO* consumers. On February 9, 2018, *MERALCO*'s directors filed their Counter-Affidavits where they refuted the arguments of the consumer group. In a Resolution dated May 18, 2018, the criminal complaint for syndicated estafa was dismissed for insufficiency of evidence. The case was referred to the *COA* for the conduct of audit on the bill deposits collected by *MERALCO* from the public consumers and to inform the Ombudsman of the compliance therewith. The consumer group filed a Motion for Partial Reconsideration dated June 16, 2018 to which *MERALCO* filed its Comment. *MERALCO* is awaiting further action of the Office of Ombudsman on the case.

On February 28, 2018, *MERALCO* received an Order dated February 20, 2018 from the Office of the Ombudsman directing *MERALCO*'s directors to comment on a complaint-affidavit for syndicated estafa filed by certain consumer group which charged that there was conspiracy between *MERALCO* directors and the *ERC* regarding the *MERALCO*'s investment activities in other businesses for being violative of its legislative franchise and the *EPIRA*. On March 12, 2018, *MERALCO*'s directors filed their Counter-Affidavits where they refuted the arguments of the consumer group. As at July 30, 2018, *MERALCO* is awaiting further action of the Office of the Ombudsman on the matter.

(v) Any significant elements of income or loss that did not arise from the registrant's continuing operations.

None

(vi) Any seasonal aspects that had a material effect on the financial condition or results of operations.

Seasonality of Operations and Growth Drivers

Approximately 97% of *MERALCO Group*'s operating revenues pertain to sale of electricity distributed by *MERALCO* and *CEDC*.

The electricity sales of *MERALCO* and *CEDC* exhibit a degree of quarterly seasonality. The *kWh* sales in the first quarter is lower than the average of the year as this period is characterized by cooler temperature and softer consumer demand following heightened consumer spending in the last quarter of the year. The second quarter is marked by higher than average *kWh* sales. This is due to a number of factors, including: increased consumption of households and commercial establishments due the summer season; increased production of industries to replenish stocks and in preparation for the opening of classes; and, heightened construction activity to take advantage of the sunny weather. In the third quarter of the year, manufacturing industries that cater to the export market have their peak production schedule at this time as they rush to meet shipping deadlines to foreign markets. Industries catering to the domestic market are also now starting production in preparation for the Christmas season. Lastly, the fourth quarter performance is about the average of the year. Industrial production winds down while households and commercial establishments also cut down on their cooling loads. Given this perspective on the seasonality of *kWh* sales, a higher proportion of the *MERALCO*'s and *CEDC*'s revenues are earned on the second half of the year.

Aside from the quarterly seasonal pattern, *kWh* sales on a year-on-year basis adjust as a result of a number of factors. Sales of electricity normally increase in periods of economic growth, low inflation and electricity rates, and in periods of high temperatures over extended period of time, e.g. the "*El Niño*" episodes.

The following table sets forth *MERALCO Group*'s 2018 quarterly sales in *GWh*.

First Quarter	10,145
Second Quarter	11,520
Third Quarter	–
Fourth Quarter	–
Total	21,665

The businesses of all other subsidiaries are not highly seasonal.

- **Any known trends, demands, commitments, events or uncertainties that will have a material impact of the issuer's liquidity.**

The Management is not aware of any known trends, demands, commitments, events or uncertainties that may deem potentially have a material impact on *MERALCO* Group's liquidity as at June 30, 2018.

- **Discussion of *MERALCO*'s and its majority-owned subsidiaries top five (5) key performance indicators. It shall include a discussion of the manner by which *MERALCO* calculates or identifies the indicators presented on a comparable basis.**

Listed hereunder are *MERALCO*'s five (5) major subsidiaries namely *CEDC*, *MGen*, *MIESCOR*, *e-MVI* and *CIS*. The following table summarizes their key financial performance and indicators as at and for the six months ended June 30, 2018 and 2017.

Financial Highlights and Ratio[12] of Major Subsidiaries
As at and for the Six Months Ended June 30, 2018 and 2017
(Amounts in million pesos except for financial ratios and % change)

	CEDC			*MGen*			*MIESCOR*			*e-MVI*			*CIS*		
	2018	**2017**	**% change**	**2018**	**2017**	**% change**	**2018**	**2017**	**% change**	**2018**	**2017**	**% change**	**2018**	**2017**	**% change**
Percentage of ownership	65%	65%		100%	100%		99%	99%		100%	100%		100%	100%	
Condensed Statements of Financial Position															
Total assets	2,252	2,190	3	17,947	17,798	1	3,889	4,038	(4)	2,312	1,882	23	2,290	1,855	23
Current assets	1,089	1,310	(17)	6,880	7,556	(9)	3,018	3,225	(6)	1,095	773	42	2,171	1,941	12
Cash and cash equivalents	772	847	(9)	703	1,563	(55)	386	417	(7)	802	487	65	1,043	990	5
Equity	1,413	1,337	6	17,836	17,699	1	1,414	1,314	8	1,907	1,560	22	1,010	808	25
Total debt[13]	–	–	–	–	–	–	580	577	1	–	–		–	–	–
Current liabilities	445	428	4	64	58	10	2,232	2,442	(9)	346	266	30	1,265	1,032	23
Financial Ratios															
Debt-to-equity ratio	–	–	–	–	–	–	0.44	0.44	(7)	–	–	–	–	–	–
Current ratio	2.45	3.06	(20)	107.50	130.28	(17)	1.35	1.32	2	3.16	2.91	9	1.72	1.88	(9)
Condensed Statements of Income															
Revenues	1,327	1,528	(13)	–	–	–	1,651	1,755	(6)	619	517	20	821	743	10
Costs and expenses	1,220	1,394	(12)	300	287	5	1,619	1,715	(6)	318	275	16	637	563	13
Net income (loss)	19	127	(85)	(100)	20	(600)	30	32	(6)	260	178	46	125	130	(4)
Financial Ratios															
Profit margin	1.4%	8.3%	(83)	–	–	–	1.8%	1.8%	–	42.0%	34.4%	22	15.2%	17.5%	(13)
Return on equity	1.3%	9.5%	(86)	(0.6%)	0.1%	(596)	2.1%	2.4%	(13)	13.6%	11.4%	19	12.4%	16.1%	(68)
Asset turnover	0.59	0.70	(16)	–	–	–	0.42	0.43	(2)	0.27	0.27	(3)	0.36	0.40	(10)

12 The manner of computing the financial ratios for subsidiaries is the same with that of *MERALCO's* as presented in *Financial Highlights and Key Performance Indicators*.

13 Total Debt is composed of notes payable and interest-bearing long-term financial liabilities, current and non-current portions.

ANNEX – Aging of Trade and Other Receivables

As at June 30, 2018

(Amounts in millions)

	T o t a l	1 - 30 days	31 - 60 days	61 - 90 days	Over 90 days
Trade receivables	₱23,639	₱19,486	₱766	₱203	₱3,184
Other trade receivables	4,313	1,928	177	83	2,125
Gross trade receivables	**27,952**	**21,414**	**943**	**286**	**5,309**
Non-trade receivables	1,555	960	31	403	161
Total receivables	**29,507**	**22,374**	**974**	**689**	**5,470**
Allowance for doubtful accounts	**(1,837)**	**–**	**–**	**–**	**(1,837)**
Net receivables	**₱27,670**	**₱22,374**	**₱974**	**₱689**	**₱3,633**

Manila Electric Company and Subsidiaries

Consolidated Financial Statements as at June 30, 2018 (Unaudited) and December 31, 2017 (Audited)

and

For the Six Months Ended June 30, 2018 and 2017 (Unaudited)

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
ASSETS			
Noncurrent Assets			
Utility plant and others	*7, 10 and 15*	**₱136,980**	₱133,874
Investments in associates and interests in joint ventures	*8 and 22*	**11,943**	11,446
Investment properties	*9 and 15*	**1,506**	1,509
Deferred tax assets - net	*27*	**18,490**	16,146
Other noncurrent assets	*2, 7, 10, 14, 26, 28 and 29*	**50,514**	41,948
Total Noncurrent Assets		**219,433**	204,923
Current Assets			
Cash and cash equivalents	*11, 24 and 26*	**50,778**	45,937
Trade and other receivables	*12 and 26*	**27,670**	26,288
Inventories	*13 and 24*	**3,447**	3,330
Other current assets	*10, 14, 22 and 26*	**22,632**	22,877
Total Current Assets		**104,527**	98,432
Total Assets		**₱323,960**	₱303,355
EQUITY AND LIABILITIES			
Equity Attributable to Equity Holders of the Parent			
Common stock	*15*	**₱11,273**	₱11,273
Additional paid-in capital		**4,111**	4,111
Equity reserve	*3*	**(116)**	(126)
Employee stock purchase plan	*15*	**1,049**	1,049
Unrealized fair value losses on available-for-sale (*AFS*) financial assets	*10*	**(336)**	(160)
Remeasurement adjustments on retirement and other post-employment liabilities	*25*	**749**	2,329
Share in remeasurement adjustments on associates' retirement liabilities	*8*	**(10)**	(10)
Cumulative translation adjustments of subsidiaries and associates	*8*	**1,546**	1,175
Treasury shares	*15*	**(11)**	(11)
Retained earnings	*15*	**56,863**	53,980
Equity Attributable to Equity Holders of the Parent		**75,118**	73,610
Non-controlling Interests		**821**	822
Total Equity		**75,939**	74,432

(Forward)

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Noncurrent Liabilities			
Interest-bearing long-term financial liabilities - net of current portion	*16, 24 and 26*	**₱24,410**	₱24,786
Customers' deposits - net of current portion	*17, 21 and 26*	**25,165**	24,000
Long-term employee benefits	*25*	**7,960**	4,559
Provisions	*18, 21 and 28*	**18,154**	18,456
Refundable service extension costs - net of current portion	*21 and 26*	**6,554**	6,012
Deferred tax liabilities - net	*27*	**60**	52
Other noncurrent liabilities	*2, 5, 7, 23 and 28*	**52,501**	45,219
Total Noncurrent Liabilities		**134,804**	123,084
Current Liabilities			
Notes payable	*20, 24 and 26*	**13,634**	13,586
Trade payables and other current liabilities	*15, 16, 17, 18, 21, 22, 23, 26 and 28*	**91,040**	83,950
Customers' refund	*2, 19 and 26*	**4,453**	4,603
Income tax payable		**2,252**	1,816
Current portion of interest-bearing long-term financial liabilities	*16, 24 and 26*	**1,838**	1,884
Total Current Liabilities		**113,217**	105,839
Total Liabilities		**248,021**	228,923
Total Liabilities and Equity		**₱323,960**	₱303,355

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF INCOME

		Unaudited			
		For the Six Months Ended June 30		For the Three Months Ended June 30	
	Note	**2018**	2017	**2018**	2017
		(Amounts in millions, except per share data)			
REVENUES					
Sale of electricity	*22, 23, 29 and 31*	**₱146,903**	₱137,409	**₱77,894**	₱72,685
Sale of other services	*9 and 22*	**3,641**	3,623	**1,843**	1,771
		150,544	141,032	**79,737**	74,456
COSTS AND EXPENSES					
Purchased power	*23 and 29*	**116,330**	107,683	**61,482**	56,062
Salaries, wages and employee benefits	*24 and 25*	**6,408**	6,383	**3,189**	3,252
Provision for probable losses and expenses from claims	*18, 23 and 28*	**4,673**	4,049	**3,379**	3,045
Depreciation and amortization	*7, 9 and 10*	**3,615**	3,462	**1,852**	1,725
Contracted services		**2,985**	3,012	**1,532**	1,522
Taxes, fees and permits		**503**	573	**172**	216
Other expenses	*22 and 24*	**2,347**	2,381	**1,182**	1,209
		136,861	127,543	**72,788**	67,031
OTHER INCOME (EXPENSES)					
Interest and other financial income	*11 and 24*	**1,210**	1,075	**616**	547
Interest and other financial charges	*7, 16, 17, 20 and 24*	**(1,034)**	(750)	**(352)**	(379)
Foreign exchange gains		**1,531**	281	**1,155**	97
Equity in net earnings (losses) of associates and joint ventures	*8*	**(146)**	230	**(279)**	93
Others	*2, 22 and 29*	**287**	264	**96**	143
		1,848	1,100	**1,236**	501
INCOME BEFORE INCOME TAX		**15,531**	14,589	**8,185**	7,926
PROVISION FOR (BENEFIT FROM) INCOME TAX	*27*				
Current		**5,177**	5,389	**2,605**	3,178
Deferred		**(1,643)**	(1,368)	**(1,110)**	(971)
		3,534	4,021	**1,495**	2,207
NET INCOME		**₱11,997**	₱10,568	**₱6,690**	₱5,719
Attributable To					
Equity holders of the Parent	*30*	**₱11,973**	₱10,501	**₱6,661**	₱5,684
Non-controlling interests		**24**	67	**29**	35
		₱11,997	₱10,568	**₱6,690**	₱5,719
Earnings Per Share Attributable to Equity Holders of the Parent	*30*				
Basic		**₱10.62**	₱9.32	**₱5.91**	₱5.04
Diluted		**10.62**	9.32	**5.91**	5.04

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

		Unaudited			
		For the Six Months Ended June 30		For the Three Months Ended June 30	
	Note	**2018**	2017	**2018**	2017
		(Amounts in millions)			
NET INCOME		**₱11,997**	₱10,568	**₱6,690**	₱5,719
OTHER COMPREHENSIVE INCOME					
Items that will be reclassified to profit or loss in subsequent periods:					
Unrealized fair value gain (loss) on available-for-sale financial assets	*10*	**(169)**	261	**(35)**	53
Income tax effect		**(7)**	(26)	**(3)**	(5)
		(176)	235	**(38)**	48
Cumulative translation adjustments of subsidiaries and associates	*8*	**371**	(270)	**299**	(281)
Items that will not be reclassified to profit or loss in subsequent periods:					
Remeasurement adjustments on retirement and other post-employment liabilities	*25*	**(2,256)**	(26)	**(1,069)**	–
Income tax effect		**676**	8	**322**	–
		(1,580)	(18)	**(747)**	–
Share in remeasurement adjustments on associates' retirement liabilities		–	2	–	2
OTHER COMPREHENSIVE LOSS, NET OF INCOME TAX		**(1,385)**	(51)	**(486)**	(231)
TOTAL COMPREHENSIVE INCOME, NET OF INCOME TAX		**₱10,612**	₱10,517	**₱6,204**	₱5,488
Total Comprehensive Income Attributable To					
Equity holders of the Parent		**₱10,588**	₱10,450	**₱6,175**	₱5,453
Non-controlling interests		**24**	67	**29**	35
		₱10,612	₱10,517	**₱6,204**	₱5,488

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017

	Common Stock (Note 15)	**Additional Paid-in Capital**	**Equity Reserve** (Note 3)	**Employee Stock Purchase Plan** (Note 15)	**Unrealized Fair Value Gains (Losses) on AFS Financial Assets** (Note 10)	**Remeasurement Adjustments on Retirement and Other Post-Employment Liabilities** (Note 25)	**Share in Remeasurement Adjustments on Associates' Retirement Liabilities** (Note 8)	**Cumulative Translation Adjustments of Subsidiaries and Associates** (Note 8)	**Treasury Shares** (Note 15)	**Retained Earnings** (Note 15)	**Equity Attributable to Equity Holders of the Parent**	**Non-controlling Interests** (Note 6)	**Total Equity**
						(Amounts in millions)							
At January 1, 2018	**₱11,273**	**₱4,111**	**(₱126)**	**₱1,049**	**(₱160)**	**₱2,329**	**(₱10)**	**₱1,175**	**(₱11)**	**₱53,980**	**₱73,610**	**₱822**	**₱74,432**
Net income	–	–	–	–	–	–	–	–	–	**11,973**	**11,973**	**24**	**11,997**
Other comprehensive income (loss)	–	–	–	–	**(176)**	**(1,580)**	–	**371**	–	–	**(1,385)**	–	**(1,385)**
Total comprehensive income (loss)	–	–	–	–	**(176)**	**(1,580)**	–	**371**	–	**11,973**	**10,588**	**24**	**10,612**
Dividends	–	–	–	–	–	–	–	–	–	**(9,090)**	**(9,090)**	**(27)**	**(9,117)**
Additional investment of non-controlling interests	–	–	–	–	–	–	–	–	–	–	–	**2**	**2**
Excess of acquisition cost of controlling interest over carrying value of additional minority interest	–	–	**10**	–	–	–	–	–	–	–	**10**	–	**10**
At June 30, 2018	**₱11,273**	**₱4,111**	**(₱116)**	**₱1,049**	**(₱336)**	**₱749**	**(₱10)**	**₱1,546**	**(₱11)**	**₱56,863**	**₱75,118**	**₱821**	**₱75,939**
At January 1, 2017	₱11,273	₱4,111	(₱328)	₱1,049	(₱271)	₱3,384	(₱12)	₱1,085	(₱11)	₱54,137	₱74,417	₱729	₱75,146
Net income	–	–	–	–	–	–	–	–	–	10,501	10,501	67	10,568
Other comprehensive income (loss)	–	–	–	–	235	(18)	2	(270)	–	–	(51)	–	(51)
Total comprehensive income (loss)	–	–	–	–	235	(18)	2	(270)	–	10,501	10,450	67	10,517
Dividends	–	–	–	–	–	–	–	–	–	(10,482)	(10,482)	(21)	(10,503)
At June 30, 2017	₱11,273	₱4,111	(₱328)	₱1,049	(₱36)	₱3,366	(₱10)	₱815	(₱11)	₱54,156	₱74,385	₱775	₱75,160

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

		Unaudited	
		For the Six Months Ended June 30	
	Note	**2018**	2017
		(Amounts in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax		**₱15,531**	₱14,589
Adjustments for:			
Depreciation and amortization	*7, 9 and 10*	**3,615**	3,462
Provision for probable losses and expenses from claims - net	*18, 23 and 28*	**4,451**	4,049
Interest and other financial charges	*24*	**1,034**	750
Interest and other financial income	*24*	**(1,210)**	(1,075)
Equity in net losses (earnings) of associates and joint ventures	*8*	**146**	(230)
Provision for doubtful accounts	*12*	**7**	6
Others		**(1,216)**	(187)
Operating income before working capital changes		**22,358**	21,364
Decrease (increase) in:			
Trade and other receivables		**(9,305)**	(5,669)
Inventories		**(117)**	(258)
Other current assets		**1,887**	(248)
Increase (decrease) in:			
Trade payables and other current liabilities		**7,123**	461
Customers' deposits		**2,073**	2,049
Customers' refund		**(150)**	(289)
Long-term employee benefits		**1,113**	682
Cash generated from operations		**24,982**	18,092
Income tax paid		**(3,521)**	(3,891)
Net cash flows provided by operating activities		**21,461**	14,201
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to:			
Utility plant and others	*7*	**(6,379)**	(5,154)
Short-term investments	*14*	**(5,870)**	–
Held-to-maturity investments	*10*	**(4,433)**	(55)
Available-for-sale financial assets	*10*	**(3,520)**	(20,841)
Investments in associates and interests in joint ventures	*8 and 14*	**(292)**	(636)
Intangible assets	*10*	**(120)**	(48)
Proceeds from sale of:			
Held-to-maturity investments		**7,575**	850
Available-for-sale financial assets		**3,719**	20,563
Interest and other financial income received		**1,144**	546
Proceeds from disposal of utility plant and others		**201**	76
Dividends received from associates		**7**	–
Decrease in minority interest		**(25)**	–
Decrease in other noncurrent assets		**433**	46
Net cash used in investing activities		**(7,560)**	(4,331)

(Forward)

		Unaudited	
		For the Six Months Ended June 30	
	Note	**2018**	2017
		(Amounts in millions)	
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from:			
Availment of notes payable	*20*	**₱1,423**	₱1,313
Disposal of non-controlling interest	*3*	**10**	–
Availment of interest-bearing long-term financial liabilities	*16*	**–**	500
Payments of:			
Dividends	*15*	**(9,020)**	(10,560)
Notes payable	*20*	**(1,375)**	(1,526)
Interest and other financial charges		**(784)**	(759)
Interest-bearing long-term financial liabilities		**(435)**	(388)
Increase in other noncurrent liabilities		**1,121**	620
Net cash used in financing activities		**(9,060)**	(10,800)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**4,841**	(930)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		**45,937**	46,656
CASH AND CASH EQUIVALENTS AT END OF PERIOD	*11*	**₱50,778**	₱45,726

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

1. **Corporate Information**

Manila Electric Company ("*MERALCO*") holds a congressional franchise under Republic Act ("*RA*") No. 9209 effective June 28, 2003. *RA* No. 9209 grants *MERALCO* a 25-year franchise valid through June 28, 2028 to construct, operate, and maintain the electric distribution system in the cities and municipalities of Bulacan, Cavite, Metro Manila, and Rizal and certain cities, municipalities and barangays in the provinces of Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the Energy Regulatory Commission ("*ERC*") granted *MERALCO* a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until the expiration of *MERALCO*'s congressional franchise. *MERALCO*'s participation in retail electricity supply ("*RES*") is directly through its local *RES* unit, *MPower* and indirectly through its affiliate *RES* entities. The *ERC* granted the following subsidiaries distinct *RES* licenses to operate as affiliate retail electricity suppliers in Luzon and Visayas, namely; Vantage Energy Solutions and Management, Inc. ("*Vantage*"), a wholly owned subsidiary of *MERALCO*; Solvre, Inc., a wholly owned subsidiary of MERALCO PowerGen Corporation ("*MGen*"); and MeridianX Inc. ("*MeridianX*"), a wholly owned subsidiary of Comstech Integration Alliance, Inc. ("*Comstech*", 60% owned by *MERALCO*), on January 10, 2017, February 9, 2017 and February 9, 2017, respectively.

The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, Clark Electric Distribution Corporation ("*CEDC*"). *CEDC* is a registered private distribution utility with a franchise granted by Clark Development Corporation ("*CDC*") to own, operate and maintain a power distribution system and to distribute power exclusively within its franchise area, which includes the Clark Freeport Zone and the sub-zone as determined pursuant to Presidential Decree No. 66 and the Joint Venture Agreement executed between *CDC* and Meralco Industrial Engineering Services Corporation ("*MIESCOR*") dated February 19, 1997.

MERALCO is developing power generation plants and renewable energy plants or facilities through its wholly owned subsidiary, *MGen*, and is engaged in rooftop solar energy projects through its wholly owned subsidiary, MSpectrum, Inc. ("*Spectrum*") and mini-hydro power plant projects through a joint-venture company, Pure Meridian Hydropower Corporation ("*Pure Meridian*"). Through several subsidiaries in the services segment, *MERALCO* provides engineering, design, construction and consulting services, bill collection services, distribution and energy management services, and communications, information systems and technology services.

MERALCO manages the electric distribution facilities of Pampanga Electric Cooperative II ("*PELCO II*") through *Comstech* under an Investment Management Contract ("*IMC*"). *MERALCO* also manages the electric distribution facilities in the Cavite Economic Zone ("*CEZ*") under a 25-year concession agreement with Philippine Economic Zone Authority ("*PEZA*").

MERALCO is owned directly by two (2) major stockholder groups, Metro Pacific Investments Corporation ("*Metro Pacific*") and JG Summit Holdings, Inc. ("*JG Summit*"). *Metro Pacific* has combined direct equity interests in *MERALCO* and indirect ownership through its wholly owned subsidiary, Beacon Electric Asset Holdings, Inc. *Metro Pacific*'s combined direct and indirect ownership interests in *MERALCO* totaled 45.46% as at June 30, 2018 and December 31, 2017. *JG Summit* has 29.56% direct ownership interest in *MERALCO* as at June 30, 2018 and December 31, 2017. First Philippine Holdings Corporation ("*First Holdings*") and First Philippine Utilities Corporation, also have direct equity ownership in *MERALCO.* The balance of *MERALCO*'s common shares is held by institutional investors and the public.

On January 29, 2018, the Board of Directors ("*BOD*") approved the amendment of the Fourth Article of the Articles of Incorporation of *MERALCO* to extend the corporate term for another 50 years from May 7, 2019. On May 29, 2018, the stockholders approved the amendment.

The common shares of *MERALCO* are listed and traded in the Philippine Stock Exchange ("*PSE*") with ticker symbol, *MER*.

The registered office address of *MERALCO* is Lopez Building, Ortigas Avenue, Barangay Ugong, Pasig City, Metro Manila, Philippines.

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2. **Rate Regulations**

As distribution utilities ("*DUs*"), *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC.* Billings of *MERALCO* and *CEDC* to customers are itemized or "unbundled" into a number of bill components that reflect the various activities and costs incurred in providing electric service. The adjustment to each bill component is governed by mechanisms promulgated and enforced by the *ERC*, mainly: [i] the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities", which govern the recovery of pass-through costs, including over- or under-recoveries of the bill components, namely, (a) generation charge, (b) transmission charge, (c) system loss ("*SL*") charge, (d) lifeline and inter-class rate subsidies, and (e) local franchise tax ("*LFT*"); and [ii] the "Rules for the Setting of Distribution Wheeling Rates" ("*RDWR*"), as modified by the *ERC* on December 1, 2009, which govern the determination of *MERALCO*'s distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in accordance with the *ERC* regulations. The following is a discussion of matters related to rate-setting of *MERALCO* and *CEDC*:

Performance-Based Regulations ("*PBR*")

MERALCO

MERALCO is among the Group A entrants to the *PBR*, together with two (2) other private *DU*s.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs once every Regulatory Period ("*RP*") based on the regulated asset base ("*RAB*") of each *DU*, and the required operating and capital expenditures to meet operational performance and service level requirements responsive to the need for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC. PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) Regulatory Years ("*RYs*"). A *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. The 4th *RP* for Group A *DU*s began on July 1, 2015 and shall end on June 30, 2019.

MAP for RY 2012

On June 21, 2011, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2012 and translation into rate tariffs by customer category. In an order dated October 3, 2011, the *ERC* provisionally approved the *MAP* for *RY* 2012 of ₱1.6012 per kiloWatt hour ("*kWh*") and the rate translation per customer class was implemented starting October 2011. Hearings for the final

approval of the application have been completed and all parties have submitted their respective memoranda. As at July 30, 2018, the application is pending final approval by the *ERC*.

MAP for RY 2013

On March 30, 2012, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2013 and the translation thereof into rate tariffs by customer category. On June 11, 2012, the *ERC* provisionally approved the *MAP* for *RY* 2013 of ₱1.6303 per *kWh,* which was reflected in the customer bills starting July 2012. Hearings on this case have been completed. As at July 30, 2018, the application is pending final approval by the *ERC*.

MAP for RY 2014

On April 1, 2013, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2014 of ₱1.6510 per *kWh* and the translation thereof into rate tariffs by customer category. On June 10, 2013, the *ERC* provisionally approved the *MAP* for *RY* 2014 of ₱1.6474 per *kWh* and the rate translation per customer class. As at July 30, 2018, the application is pending final approval by the *ERC*.

MAP for RY 2015

On March 31, 2014, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the translation thereof into rate tariffs by customer category. On May 5, 2014, the *ERC* provisionally approved *MERALCO*'s *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the rate translation per customer class. As at July 30, 2018, the application is pending final approval by the *ERC*.

4th RP Reset Application

MERALCO's 3rd *RP* ended on June 30, 2015 and is currently operating in the 4th *RP*. On April 12, 2016, to initiate the reset process, the *ERC* posted on its website the following draft issuance for comments:

a. Draft "Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Operating under Performance Based Regulation, First Entry Group: Fourth Regulatory Period";

b. Draft "Position Paper: Regulatory Reset for the July 1, 2015 to June 30, 2019 Fourth Regulatory Period for the First Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation"; and

c. Draft "Commission Resolution on the Issues on the Implementation of *PBR* for Privately Owned *DU*s under the *RDWR*".

Under *ERC* Resolution No. 25, Series of 2016 dated July 12, 2016, the *ERC* promulgated a Resolution modifying the *RDWR* for privately-owned *DU*s entering the *PBR*. The *ERC* has directed *MERALCO* and Private Electric Power Operators Association ("*PEPOA*") to publish the Resolution. However, *MERALCO* is seeking clarification from the *ERC* on certain issues in the Resolution, including the need to await the final decision of the *ERC* on the Petition for Rule Making filed by a consumer group to amend the *PBR*.

An initial hearing on the Petition for Rule Making filed by a consumer group was originally set by the *ERC* for January 9, 2017 and all interested parties were to file their comments on the Petition by December 26, 2016. *MERALCO* filed its Comment to the Petition on January 9, 2017.

Subsequently, however, the *ERC* reset the hearing to January 23, 2017. Hearings were further conducted on May 15 and June 21, 2017. As at July 30, 2018, the *ERC* Order for the date of the next public consultation is pending.

In a Notice dated November 16, 2016, the *ERC* approved the draft "Regulatory Asset Base Roll Forward Handbook for Privately Owned Electricity Distribution Utilities" ("*RAB Handbook*") for posting in its website. All interested parties had until December 19, 2016 to submit their respective comments to the draft *RAB Handbook*. Thereafter, during the public consultation on January 9, 2017, the parties were given until February 9, 2017 to file their comments to the draft *RAB Handbook*. In an Omnibus Motion filed on February 9, 2017, *MERALCO* submitted its initial comments to the draft *RAB Handbook* but moved for the deferment of the proceedings until the consumer group's Petition as referred in the foregoing has been resolved. As at July 30, 2018, the *ERC* has yet to resolve *MERALCO*'s Omnibus Motion.

Interim Average Rate beginning RY 2016

On June 11, 2015, *MERALCO* filed its application for the approval of a proposed Interim Average Rate of ₱1.3939 per *kWh* and translation thereof into rate tariffs by customer category. On July 10, 2015, the *ERC* provisionally approved an Interim Average Rate of ₱1.3810 per *kWh* and the rate translation per customer class, which was reflected in the customer bills starting July 2015. *MERALCO* has completed the presentation of its evidence and is set to file its Formal Offer of Evidence ("*FOE*") after the *ERC* rules on pending motions. As at July 30, 2018, the *ERC*'s ruling on these motions is pending.

Capital Expenditures ("*CAPEX*") *for RY 2016*

Absent the release by the *ERC* of the final rules to govern the filing of its 4th *RP* reset, *MERALCO* filed on February 9, 2015 an application for approval of authority to implement its *CAPEX* program for *RY* 2016 (July 1, 2015 to June 30, 2016) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act. On June 15, 2016, *MERALCO* received a copy of the *ERC* Decision dated April 12, 2016 which partially approved *MERALCO*'s *CAPEX* program for *RY* 2016 amounting to ₱15.5 billion out of the total *RY* 2016 *CAPEX* of ₱17.7 billion, subject to certain conditions. An intervenor has filed a Motion for Reconsideration ("*MR*") on the Decision which is pending before the *ERC*. On July 25, 2016, *MERALCO* filed its opposition to the *MR*. As at July 30, 2018, the *ERC* ruling on the *MR*s is pending.

CAPEX for RY 2017

On March 8, 2016, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program for *RY* 2017 (July 1, 2016 to June 30, 2017) pursuant to the Public Service Act. On July 26, 2016, *MERALCO* received the Order dated May 5, 2016, which partially approved *MERALCO*'s *CAPEX* program for *RY* 2017 amounting to ₱8.8 billion out of the total *RY* 2017 *CAPEX* of ₱15.4 billion, subject to certain conditions. On August 10, 2016, *MERALCO* filed a Motion for Partial Reconsideration on the requirement to submit an accounting of the depreciation fund. Hearings on the application have been completed. On September 14, 2016, *MERALCO* filed a Motion for Resolution. Subsequently, on April 25, 2017, *MERALCO* filed a Very Urgent Motion for Resolution of the application. Thereafter, on October 18, 2017, *MERALCO* filed a Manifestation and Urgent Motion for Resolution. On November 9, 2017, *MERALCO* filed a Manifestation with Third Urgent

Motion to Resolve the Application. As at July 30, 2018, *MERALCO* is awaiting the final decision of the *ERC*.

CAPEX for RY 2018

On April 3, 2017, *MERALCO* filed an application for approval of authority to implement its ₱18.8 billion *CAPEX* program for *RY* 2018 (July 1, 2017 to June 30, 2018) pursuant to the Public Service Act. On May 26, 2017, *MERALCO* received the Order dated May 15, 2017, which set the case for initial hearing. Hearings were conducted on June 22 and August 1, 2017, August 25, 2017 and September 22, 2017. A conference was also conducted with the *ERC* technical staff and the intervenor on October 12, 2017. On November 9, 2017, *MERALCO* filed its *FOE*. *MERALCO* also filed Manifestations on November 9, 2017 and March 28, 2018, informing the *ERC* that it was constrained to implement several projects in order to avert service interruptions to its customers and maintain a robust distribution infrastructure. As at July 30, 2018, the case has been submitted for decision.

CAPEX for RY 2019

On April 30, 2018, *MERALCO* filed an application for approval of authority to implement its ₱21.0 billion *CAPEX* program for *RY* 2019 (July 1, 2018 to June 30, 2019) pursuant to the Public Service Act. On July 9, 2018, *MERALCO* filed a Very Urgent Motion for Issuance of Provisional Authority and to set case for initial hearing. As at July 30, 2018, *MERALCO* is awaiting further action of the *ERC*.

CEDC

CEDC is among the four (4) Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. A *RY* for *CEDC* begins on October 1 and ends on September 30. The 3rd *RP* for *CEDC* began on October 1, 2015 and shall end on September 30, 2019. *CEDC* is to undergo the reset process and is awaiting the release by the *ERC* of the final rules to govern the filing of its 3rd *RP* reset application.

3rd RP PBR Reset for CEDC

Pending the release by the *ERC* of the final rules to govern the filing of its 3rd *RP* Reset application and absence of subsequent rate translation process thereto, the approved *MAP* for *RY* 2015 was used beginning *RY* 2016.

On February 18 and December 29, 2016, *CEDC* filed with the *ERC* its Proposed *CAPEX* program for *RY*s 2016 and 2017, respectively. *CEDC* applied for an approval to implement the *CAPEX* in order to continue to meet the electricity needs of its current and future customers, improve the flexibility, reliability and stability of its distribution network as well as improve customer service.

SC Decision on Unbundling Rate Case

On May 30, 2003, the *ERC* issued an Order approving *MERALCO*'s unbundled tariffs that resulted in a total increase of ₱0.17 per *kWh* over the May 2003 tariff levels. However, on August 4, 2003, *MERALCO* received a Petition for Review of the *ERC*'s ruling filed by certain consumer and civil society groups before the Court of Appeals ("*CA*"). On July 22, 2004, the *CA* set aside the *ERC*'s ruling on *MERALCO*'s rate unbundling and remanded the case to the *ERC*. Further, the *CA* opined that the *ERC* should have asked the Commission on Audit ("*COA*") to audit the books of *MERALCO*. The *ERC* and *MERALCO* subsequently filed separate motions asking the *CA* to reconsider its

decision. As a result of the denial by the *CA* of the motions on January 24, 2005, the *ERC* and *MERALCO* elevated the case to the *SC*.

In an En Banc decision promulgated on December 6, 2006, the *SC* set aside and reversed the *CA* ruling saying that a *COA* audit was not a prerequisite in the determination of a utility's rates. However, while the *SC* affirmed *ERC*'s authority in rate-fixing, the *SC* directed the *ERC* to request *COA*'s assistance to undertake a complete audit of the books, records and accounts of *MERALCO*. In compliance with the directive of the *SC*, the *ERC* requested *COA* to conduct an audit of the books, records and accounts of *MERALCO* using calendar years 2004 and 2007 as test years.

The *COA* audit, which began in September 2008, was completed with the submission to the *ERC* of its report on November 12, 2009.

On February 15, 2010, the *ERC* issued its Order directing *MERALCO* and all intervenors in the case to submit, within 15 days from receipt of the Order, their respective comments on the *COA* report.

On June 21, 2011, the *ERC* maintained and affirmed its findings and conclusions in its Decision dated March 20, 2003 and Order dated May 30, 2003. The *ERC* stated that the *COA* recommendation to apply disallowances under *PBR* to rate unbundling violates the principle against retroactive rate-making. An intervenor group filed a *MR* of the said Order. On September 5, 2011, *MERALCO* filed its comment on the intervenor's *MR*. On February 4, 2013, the *ERC* denied the intervenor's *MR*. The intervenor filed a Petition for Review before the *CA* and *MERALCO* filed its comment thereon on May 29, 2014. In compliance with the *CA*'s directive, *MERALCO* filed its Memorandum in August 2015. In a Resolution dated September 29, 2015, the *CA* acknowledged receipt of the respective memoranda from parties and declared the case submitted for decision. In a Decision dated February 29, 2016, the *CA* dismissed the Petition for Review and affirmed the orders dated June 21, 2011 and February 4, 2013 of the *ERC*.

On March 22, 2016, the intervenors filed a *MR* on the *CA* Decision dated February 29, 2016. The same was denied by the *CA* through a Resolution dated August 8, 2016.

On October 11, 2016, *MERALCO* received a Petition for Review on Certiorari filed by the intervenors before the *SC* appealing the dismissal of its Petition. *MERALCO*, *COA* and the *ERC* have filed their respective comments to the Petition. On June 22, 2017, *MERALCO* received the Motion for Leave to Intervene and Admit Comment-in-Intervention filed by other *DU*s that sought to intervene in the case. In a Resolution dated July 11, 2017, the *SC* required the parties to comment on the Motion for Leave to Intervene and Comment-in-Intervention. The intervenors filed their Comments dated September 19, 2017. *MERALCO* filed its Comments on October 18, 2017. On October 27, 2017, *COA* filed its Comments to the Motion for Leave to Intervene and Admit Comment-in-Intervention. As at July 30, 2018, further action of the *SC* on the matter is pending.

Applications for the Confirmation of Under- or Over-recoveries of Pass-through Charges

MERALCO

On July 13, 2009, the *ERC* issued Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities". These rules govern the recovery of pass-through costs, including under- or over-recoveries with respect to the following bill components: generation charge, transmission charge, *SL* charge, lifeline and inter-class rate subsidies, *LFT* and business tax. On October 18, 2010, the *ERC* promulgated *ERC* Resolution No. 21, Series of 2010, amending the *SL* true-up formula contained in Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments

implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for *DU*s in Luzon to file their respective applications. Subsequent filings shall be made every three (3) years thereafter. On December 15, 2010, the *ERC* promulgated Resolution No. 23, Series of 2010 to govern the recovery of Senior Citizen Discounts and specified that post-verification shall coincide with the timeframes in Resolution No. 16, Series of 2009, as amended by Resolution No. 21, Series of 2010.

On March 31, 2011, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries accumulated from June 2003 to December 2010 in compliance with Resolution No. 16, Series of 2009, as subsequently amended by Resolution No. 21, Series of 2010. On December 8, 2011, *MERALCO* filed a Manifestation with Omnibus Motion praying, among other things, for the admission of the Supplemental Application, which was admitted by the *ERC* in an Order dated December 12, 2011. The filing includes net generation charge under-recoveries of ₱1,000 million, net transmission charge over-recoveries of ₱111 million, net lifeline subsidy under-recoveries of ₱9 million and net *SL* over-recoveries of ₱425 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*'s application for the confirmation of its over- or under-recoveries in its pass-through costs for the period June 2003 to December 2010. The Decision directed *MERALCO* to collect net under-recoveries of ₱909 million, without carrying charges, starting the next billing cycle until such time that the full amount has been collected. The amount has been fully recovered in 2017.

On July 6, 2012, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries for the calendar year 2011. The filing includes net generation charge under-recoveries of ₱1,826 million, net transmission charge under-recoveries of ₱253 million, net lifeline subsidy under-recoveries of ₱39 million and *SL* over-recoveries of ₱445 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*'s application for the confirmation of its over- or under-recoveries in its pass-through costs for the period January to December 2011. The Decision directed *MERALCO* to collect net under-recoveries of ₱1,535 million, without carrying charges, starting the next billing cycle until such time that the full amount has been collected. The amount has been fully recovered in 2017.

On March 31, 2014, *MERALCO* filed its application with the *ERC* to confirm its under- or over- recoveries of net generation charge under-recoveries of ₱559 million, transmission charge over-recoveries of ₱639 million, net lifeline subsidy over-recoveries of ₱75 million, *SL* over-recoveries of ₱502 million from January 2012 to October 2013, and net senior citizen discount over-recoveries of ₱0.4 million from February 2011 to October 2013, excluding proposed carrying charges. Under- or over-recoveries from November and December 2013 supply months were excluded in the meantime, in view of the pending *SC* and *ERC* cases involving pass-through costs for these months. As at July 30, 2018, hearings are ongoing.

On January 29, 2016, *MERALCO* filed its application to confirm its under-recoveries of generation charge for special programs of ₱250.7 million, excluding carrying charges, covering the period March 2007 to December 2011. As at July 30, 2018, the application is pending before the *ERC*.

On March 31, 2017, *MERALCO* filed its application with the *ERC* to confirm its net generation charge over-recoveries of ₱4,919 million, net transmission charge over-recoveries of ₱632 million, net lifeline subsidy over-recoveries of ₱131 million, net *SL* over-recoveries of ₱1,243 million, net senior citizen discount over-recoveries of ₱2 million from January 2014 to December 2016 and real property tax ("*RPT*") payments under-recoveries of ₱1,090 million from June 2014 to December 2016. On May 11, 2017, the *ERC* provisionally approved *MERALCO*'s application to refund the over-recoveries of pass-through charges (generation costs, transmission costs, system loss, life line subsidies and senior citizen discount subsidy) for the period January 2014 to December 2016

amounting to ₱6,927 million. The Order deferred action on *MERALCO*'s application for the recovery of *RPT* payments, citing the absence of any rule or guideline providing for the process of confirmation, approval and recovery of *RPT*. The ₱6,927 million refund was included in the June 2017 until August 2017 billings to customers. On September 7, 2017, *MERALCO* filed a Manifestation and Motion informing the *ERC* that the absolute amounts of the remaining over/under recoveries were applied to the September 2017 billing in order to zero out the refund as directed by the *ERC*. *MERALCO* filed its *FOE* on April 27, 2018. As at July 30, 2018, the application is pending final approval before the *ERC*.

CEDC

CEDC filed its application for the approval of the calculations for the Automatic Cost Adjustment and True-up Mechanism for generation, transmission and system loss rates on April 1, 2014 in conformity with the said resolutions. Public hearing was held on June 17, 2014 and the *ERC* decision was received by *CEDC* on January 13, 2017. On January 30, 2017, *CEDC* filed a *MR* on the decision of the *ERC*. As at July 30, 2018, the *MR* is pending decision by the *ERC*.

On March 31, 2017, *CEDC* filed with the *ERC* its second application for the approval of the calculations for the Automatic Cost Adjustment and True-up Mechanism for generation, transmission and system loss rates which covered years 2014, 2015 and 2016. Public hearing was held on October 25, 2017. As at July 30, 2018, the Decision of the *ERC* is pending.

Application for Approval of the Staggered Recovery and Payment of the Differential Generation Charge for February 2017 Supply

On January 31, 2017, *MERALCO* filed an Application seeking the *ERC*'s approval of the staggered recovery and payment scheme for the generation charge for the February 2017 supply month to mitigate the impact of scheduled outages and maintenance of certain generation power plants. On March 6, 2017, the *ERC* provisionally approved the recovery of the incremental fuel cost through a staggered scheme. The incremental fuel cost was included in the March 2017 until May 2017 billings to customers. As at July 30, 2018, hearings are ongoing.

Application for the Recovery of Differential Generation Costs

On February 17, 2014, *MERALCO* filed for the recovery of the unbilled generation costs for December 2013 supply month amounting to ₱11,075 million. An amended application was filed on March 25, 2014 to adjust the unbilled generation costs for recovery to ₱1,310 million, following the receipt of Wholesale Electricity Spot Market ("*WESM*") billing adjustments based on regulated Luzon *WESM* prices. The first hearing was conducted on May 26, 2014. The *ERC* suspended the proceedings, pending resolution of issues of related cases at the *SC* involving generation costs for the November and December 2013 supply months and the regulated *WESM* prices for the said period. As at July 30, 2018, the proceedings remain suspended.

Deferred Purchase Price Adjustment ("*Deferred PPA*")

On October 12, 2009, the *ERC* released its findings on *MERALCO*'s implementation of the collection of the approved pass-through cost under-recoveries for the period June 2003 to January 2007. The *ERC* directed *MERALCO* to refund to its customers ₱268 million of Deferred *PPA* transmission line costs related to Quezon Power (Philippines) Limited Company ("*QPPL*") and deferred accounting adjustments incurred along with ₱184 million in carrying charges, or an equivalent ₱0.0169 per *kWh*. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s *Deferred PPA* under-recoveries of ₱106 million, which is not a

transmission line fee. On November 4, 2009, *MERALCO* filed an *MR* with the *ERC*. As at July 30, 2018, the *MR* is still pending resolution by the *ERC.*

Application for Recovery of LFT

On March 25, 2011, *MERALCO* filed with the *ERC* its application for recovery of *LFT* paid but not yet billed to customers for the period beginning the first quarter of 1993 up to the second quarter of 2004 for five (5) provinces, namely: Bulacan, Batangas, Cavite, Laguna and Rizal; and 14 cities, namely: San Jose Del Monte, Batangas, San Pablo, Tagaytay, Lucena, Mandaluyong, Marikina, Quezon, Caloocan, Pasay, Las Piñas, Manila, Pasig and Calamba. The *LFT* is recognized as a valid and reasonable *DU* pass-through cost in the *ERC*'s unbundling decision.

In a Decision dated February 27, 2012, the *ERC* approved with modifications *MERALCO*'s application. The *ERC* approved the recovery of *LFT* amounting to ₱1,571 million plus carrying charges of ₱730 million. As directed by the *ERC*, the recovery was reflected as a separate item in the *MERALCO* billing statement to its customers beginning April 2012. In 2017, the *LFT* plus carrying charges have been fully recovered.

On June 14, 2013, *MERALCO* filed an application with the *ERC* for authority to collect *LFT* from customers of the City of Trece Martires, with prayer for provisional authority, beginning the date of effectivity of "*The 2012 Revenue Code of Trece Martires City*" on July 1, 2012. In its Decision dated April 28, 2014, the *ERC* approved said application, with modification, and authorized *MERALCO* to recover the new *LFT* at the rate of 82.5% of 1%, prospectively, or effective its next billing cycle. With respect to the difference between the previous and the new *LFT* rates from the time said revenue code took effect, the *ERC* stated in its Decision that the same shall be considered in a separate application to be filed by *MERALCO* in accordance with the Tax Recovery Adjustment Charges ("*TRAC*") Formula under *ERC* Resolution No. 16 Series of 2009. On July 24, 2014, *MERALCO* filed a motion seeking the partial reconsideration of the Decision in so far as the filing of a separate application for *LFT* for the prior years is concerned. On October 30, 2014, *MERALCO* received the *ERC*'s Order dated September 24, 2014 denying *MERALCO*'s motion. In said Order, the *ERC* maintained its position that it shall consider in a separate application the difference between the previous and the new *LFT* rates from the time said revenue code took effect. On February 23, 2015, *MERALCO* paid the full amount of said *LFT* to the City Treasurer of Trece Martires.

On July 3, 2015, *MERALCO* filed the application for authority to recover the difference between the previous and new *LFT* rate for the calendar years 2012 to 2014 in the City of Trece Martires, under the *TRAC* formula with prayer for provisional authority, where it prayed for authority to collect from the customers in the City of Trece Martires the *LFT* amounting to ₱2 million for 2012 to 2014, which it had previously paid to the City of Trece Martires and the corresponding carrying cost**.** Hearings have been completed. On September 29, 2015, *MERALCO* filed its *FOE* with Manifestation and Compliance and thereby submitted the case for resolution. In a decision dated May 10, 2016, the *ERC* approved the application with modification.

On December 5, 2016, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Manila and Quezon City as well as for authority to refund the differential *LFT* for 2014 to 2016 under the *TRAC* formula. Hearings have been completed and *MERALCO* filed its *FOE* on June 2, 2017. However, a consumer filed a motion to intervene after the termination of the proceedings. On June 23, 2017, *MERALCO* filed its opposition thereto. As at July 30, 2018, the *ERC* resolution of the motion to intervene is pending.

On October 25, 2017, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Biñan as well as for authority to refund the differential *LFT* for 2017 under the *TRAC*

formula. In its Decision dated June 18, 2018, the *ERC* provisionally approved said application, and authorized *MERALCO* to recover the new *LFT* at the rate of 75% of 1% beginning on the date of effectivity thereof, or on January 1, 2017 and to recover the differential *LFT* in the amount of ₱10,853,401 at a rate of ₱0.0117 per *kWh* and carrying cost in the amount of ₱0.4 million at a rate of ₱0.0121 per *kWh* from the customers in the City of Biñan over a period of 12 months. The case is set for initial hearing on August 20, 2018.

SC Decision on the ₱0.167 per kWh Refund

Following the *SC*'s final ruling that directed *MERALCO* to refund affected customers ₱0.167 per *kWh* for billings made from February 1994 to April 2003, the *ERC* approved the release of the refund in four (4) phases. On December 18, 2015, *MERALCO* filed a Motion seeking the *ERC*'s approval for the continuation of the implementation of the refund to eligible accounts or customers under Phases I to IV, three (3) years from January 1, 2016 or until December 31, 2018. In said Motion, *MERALCO* likewise manifested to the *ERC* that, in order to give eligible customers the opportunity to claim their refund, and, so as not to disrupt the *SC* Refund process, *MERALCO* shall continue implementing the refund even after the December 2015 deadline, until and unless the *ERC* directs otherwise.

See *Note 19 – Customers' Refund*.

3. Basis of Preparation and Statement of Compliance

Basis of Preparation

The accompanying consolidated financial statements have been prepared on a historical cost basis, except for *MERALCO*'s utility plant and others and investment properties acquired before January 1, 2004, which are carried at deemed cost, held-to-maturity ("*HTM*") investments and available-for-sale ("*AFS*") financial assets, which are measured at fair value. *AFS* financial assets are included as part of "Other noncurrent assets" account in the consolidated statement of financial position.

All values are rounded to the nearest million peso, except when otherwise indicated.

Statement of Compliance

The consolidated financial statements of *MERALCO* and its subsidiaries have been prepared in compliance with Philippine Financial Reporting Standards ("*PFRS*").

Basis of Consolidation

The consolidated financial statements comprise the financial statements of *MERALCO* and its directly and indirectly owned subsidiaries, collectively referred to as the *MERALCO Group*.
The following table presents such subsidiaries and the respective percentage of ownership:

			June 30, 2018		December 31, 2017	
			Percentage of Ownership			
Subsidiaries	Place of Incorporation	Principal Business Activity	Direct	Indirect	Direct	Indirect
Corporate Information Solutions, Inc. ("*CIS*")	Philippines	e-Transactions	**100**	**–**	100	–
Customer Frontline Solutions, Inc. ("*CFSI*")	Philippines	Tellering services	**–**	**100**	–	100
CIS Bayad Center, Inc. ("*Bayad Center*")[1]	Philippines	Bills payment collection	**–**	**95**	–	95
Fieldtech Specialist, Inc. ("*Fieldtech*")	Philippines	Bills payment collection	**–**	**51**	–	51
Meralco Energy, Inc. ("*MServ*")	Philippines	Energy systems management	**100**	**–**	100	–
Aurora Managed Power Services, Inc. ("*AMPSI*")	Philippines	Energy systems management	**–**	**60**	–	60

(Forward)

Subsidiaries	Place of Incorporation	Principal Business Activity	June 30, 2018 Percentage of Ownership Direct	June 30, 2018 Percentage of Ownership Indirect	December 31, 2017 Percentage of Ownership Direct	December 31, 2017 Percentage of Ownership Indirect
eMeralco Ventures, Inc. ("*e-MVT*")	Philippines	e-Business development	**100**	**–**	100	–
Paragon Vertical Corporation ("*Paragon*")	Philippines	Information technology *("IT")* and multi-media services	**–**	**100**	–	100
Radius Telecoms, Inc. ("*Radius*")	Philippines	*IT* and multi-media services	**–**	**100**	–	100
MGen	Philippines	Development of power generation plants	**100**	**–**	100	–
Calamba Aero Power Corporation[2]	Philippines	Power generation	**–**	**100**	–	100
Atimonan Land Ventures Development Corporation	Philippines	Real estate	**–**	**100**	–	100
Atimonan One Energy, Inc. ("*A1E*") [2]	Philippines	Power generation	**–**	**100**	–	100
MPG Holdings Phils., Inc.	Philippines	Holding company	**–**	**100**	–	100
MPG Asia Limited ("*MPG Asia*")	British Virgin Islands	Holding company	**–**	**100**	–	100
Solvre, Inc. [2]	Philippines	Retail electricity supplier	**–**	**100**	–	100
Spectrum	Philippines	Renewable energy	**100**	**–**	100	–
Vantage	Philippines	Retail electricity supplier	**100**	**–**	100	–
Meralco Financial Services Corporation ("*Finserve*")	Philippines	Financial services provider	**100**	**–**	100	–
Lighthouse Overseas Insurance Limited ("*LOIL*")	Bermuda	Insurance	**100**	**–**	100	–
MRAIL, Inc. ("*MRail*")	Philippines	Engineering, construction and maintenance of mass transit system	**100**	**–**	100	–
Meridian Atlantic Light Company Limited [2]	Nigeria	Management of power distribution	**100**	**–**	100	–
eSakay, Inc. ("*eSakay*") [3]	Philippines	Maintenance and operation of transport service networks	**100**	**–**	–	–
MIESCOR	Philippines	Engineering, construction and consulting services	**99**	**–**	99	–
Miescor Builders Inc. ("*MBI*")	Philippines	Electric transmission and distribution operation and maintenance services	**–**	**99**	–	99
Miescor Logistics Inc. ("*MLI*")	Philippines	General services, manpower/maintenance	**–**	**99**	–	99
CEDC	Philippines	Power distribution	**65**	**–**	65	–
Clarion Energy Management Inc. ("*Clarion*") [2]	Philippines	Retail electricity supplier	**–**	**65**	–	65
Comstech	Philippines	Management of power distribution	**60**	**–**	60	–
MeridianX Inc. [2]	Philippines	Retail electricity supplier	**–**	**60**	–	60

[1] *In 2017, Densan System Limited Co. (a Japanese technology company) subscribed to 5% equity of Bayad Center. The excess of the net book value over the acquisition cost was recorded as equity reserve in the 2017 consolidated statement of financial position under equity attributable to equity holders of the parent.*

[2] *Has not started commercial operations as at June 30, 2018.*

[3] *eSakay was incorporated on March 1, 2018 and has not started commercial operations as at June 30, 2018.*

Control is achieved when the *MERALCO Group* is exposed, or has the right, to variable returns from its involvement with the investee. Specifically, the *MERALCO Group* controls an investee if and only if the *MERALCO Group* has (a) power over the investee; (b) exposure, or rights, to variable returns from its involvement with the investee; and (c) the ability to use its power over the investee to affect its returns.

When the *MERALCO Group* has less than majority of the voting or similar rights of an investee, it considers all relevant facts and circumstances in assessing whether it has power over an investee, including (a) the contractual arrangement with the other vote holders of the investee; (b) rights arising from other contractual arrangements; and (c) the *MERALCO Group*'s voting rights and potential voting rights.

The *MERALCO Group* re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one (1) or more of the three (3) elements of control. Consolidation of a subsidiary begins when the *MERALCO Group* obtains control over the subsidiary and ceases when it loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the period are included in the consolidated financial statements from the date it gains control until the date it ceases to control the subsidiary.

The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events with similar circumstances. All intra-group balances, income and expenses, unrealized gains and losses and dividends resulting from intra-group transactions are eliminated in full.

Non-controlling interests represent the portion of profit or loss and net assets in *MIESCOR* and subsidiaries*, CEDC* and subsidiary, *Comstech* and subsidiary, *AMPSI, Fieldtech* and *Bayad Center* not held by *MERALCO* and are presented separately in the consolidated statement of income, consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from equity attributable to equity holders of the parent.

Total comprehensive income within a subsidiary is attributed to the non-controlling interest even if such results in a deficit.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. In transactions where the non-controlling interest is acquired or sold without loss of control, any excess or deficit of consideration paid over the carrying amount of the non-controlling interest is recognized as part of "Equity reserve" account in the equity attributable to the equity holders of the parent.

If the *MERALCO Group* loses control over a subsidiary, it: (a) derecognizes the assets (including goodwill) and liabilities of the subsidiary; (b) derecognizes the carrying amount of any non-controlling interest; (c) derecognizes the cumulative translation adjustments deferred in equity; (d) recognizes the fair value of the consideration received; (e) recognizes the fair value of any investment retained; (f) recognizes any surplus or deficit in profit or loss; and (g) reclassifies *MERALCO*'s share of components previously recognized in the consolidated statement of comprehensive income to the consolidated statement of income.

4. Significant Accounting Policies, Changes and Improvements

Changes in Accounting Policies and Disclosures

The accounting policies adopted in the preparation of the consolidated financial statements are consistent with those of previous period except with respect to the adoption of the following new standards and amendments and improvements to existing standards, which were effective beginning January 1, 2018.

Amendments to PFRS 2, Share-based Payment, Classification and Measurement of Share-based Payment Transactions

The amendments to *PFRS 2* address three (3) main areas: (i) the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; (ii) the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and (iii) the accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

Amendments to PFRS 4, Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4

The amendments address concerns arising from implementing *PFRS 9*, the new financial instruments standard before implementing the forthcoming insurance contracts standard. They allow entities to

choose between the overlay approach and the deferral approach to deal with the transitional challenges. The overlay approach gives all entities that issue insurance contracts the option to recognize in other comprehensive income ("*OCI*"), rather than profit or loss, the volatility that could arise when *PFRS 9* is applied before the new insurance contracts standard is issued. On the other hand, the deferral approach gives entities whose activities are predominantly connected with insurance an optional temporary exemption from applying *PFRS 9* until the earlier of application of the forthcoming insurance contracts standard or January 1, 2021.

PFRS 15, Revenue from Contracts with Customers

PFRS 15 establishes a new five (5)-step model that applies to revenue arising from contracts with customers. Under *PFRS 15*, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in *PFRS 15* provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and supersedes all current revenue recognition requirements under *PFRS*s.

Based on *MERALCO Group*'s assessment, *PFRS 15* does not have a significant impact on its consolidated financial statements.

PFRS 9, Financial Instruments

PFRS 9 reflects all phases of the financial instruments project and replaces *PAS* 39, *Financial Instruments: Recognition and Measurement*, and all previous versions of *PFRS 9*. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. Retrospective application is required, but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The adoption of *PFRS 9* has an effect on the classification and measurement of the *MERALCO Group*'s financial assets and impairment methodology for financial assets, but has no impact on the classification and measurement of the *MERALCO Group*'s financial liabilities.

Amendments to PAS 28, Measuring an Associate or Joint Venture at Fair Value (Part of Annual Improvements to PFRSs 2014 – 2016 Cycle)

The amendments clarify that an entity that is a venture capital organization, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss ("*FVPL*"). They also clarify that if an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (i) the investment entity associate or joint venture is initially recognized; (ii) the associate or joint venture becomes an investment entity; and (iii) the investment entity associate or joint venture first becomes a parent.

Amendments to PAS 40, Investment Property, Transfers of Investment Property

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change

in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use.

Philippine Interpretation IFRIC-22, Foreign Currency Transactions and Advance Consideration

The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the nonmonetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration.

The foregoing new standards, and amendments and improvements to existing standards do not have impact on the consolidated financial statements of *MERALCO Group*, unless otherwise stated.

Future Changes in Accounting Policies and Disclosures

The following are the new and revised accounting standards and interpretation that are already issued but will become effective subsequent to December 31, 2018.

Effective Beginning on or after January 1, 2019

Amendments to PFRS 9, Prepayment Features with Negative Compensation

The amendments to *PFRS 9* allow debt instruments with negative compensation prepayment features to be measured at amortized cost or fair value through other comprehensive income. An entity shall apply these amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

PFRS 16, Leases

Under the new standard, lessees will no longer classify their leases as either operating or finance leases in accordance with *PAS 17*, *Leases*. Rather, lessees will apply the single-asset model. Under this model, lessees will recognize the assets and related liabilities for most leases on their balance sheets, and subsequently, will depreciate the lease assets and recognize interest on the lease liabilities in their profit or loss. Leases with a term of 12 months or less or for which the underlying asset is of low value are exempted from these requirements.

The accounting by lessors is substantially unchanged as the new standard carries forward the principles of lessor accounting under *PAS 17*. Lessors, however, will be required to disclose more information in their financial statements, particularly on the risk exposure to residual value. Entities may early adopt *PFRS 16* but only if they have also adopted *PFRS 15*. When adopting *PFRS 16*, an entity is permitted to use either a full retrospective or a modified retrospective approach, with options to use certain transition reliefs.

The *MERALCO Group* reviewed its lease contracts and other significant contracts which may qualify to be accounted for as finance lease. The *MERALCO Group* has considered whether it has control over the use of the identified assets for a period of time for these contracts.

Based on the assessment of the *MERALCO Group*, the adoption of *PFRS 16* will have no significant impact on the consolidated financial statements.

Amendments to PAS 28, Long-term Interests in Associates and Joint Ventures

The amendments to *PAS 28* clarify that entities should account for long-term interests in an associate or joint venture to which the equity method is not applied using *PFRS 9*. An entity shall apply these amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

Philippine Interpretation IFRIC-23, Uncertainty over Income Tax Treatments

The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of *PAS 12* and does not apply to taxes or levies outside the scope of *PAS 12*, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

The interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

The *MERALCO Group* is currently assessing the impact of adopting this interpretation.

Deferred Effectivity

Amendments to PFRS 10 and PAS 28, Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between *PFRS 10* and *PAS 28* in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture involves a business as defined in *PFRS 3*, *Business Combinations*. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture.

On January 13, 2016, the Financial Reporting Standards Council deferred the original effective date of January 1, 2016 of the said amendments until the International Accounting Standards Board ("*IASB*") completes its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

Significant Accounting Policies

The principal accounting policies adopted in the preparation of the consolidated financial statements are as follows:

Utility Plant and Others

Utility plant and others, except land, are stated at cost, net of accumulated depreciation, amortization and impairment losses, if any. Costs include the cost of replacing part of such utility plant and other properties when such cost is incurred, if the recognition criteria are met. All other repair and maintenance costs are recognized as incurred in the consolidated statement of income. The present value of the expected cost for the decommissioning of the asset after use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Land is stated at cost less any impairment in value.

The *MERALCO Group*'s utility plant and others acquired before January 1, 2004 are stated at deemed cost. The revalued amount recorded as at January 1, 2004 was adopted as deemed cost as allowed by the transition provisions of *PFRS 1*. The balance of revaluation increment was closed to retained earnings.

See *Note 15 – Equity* for the related discussion.

Depreciation and amortization of utility plant and others are computed using the straight-line method over the following estimated useful lives:

Asset Type	Estimated Useful Lives
Subtransmission and distribution	10-40 years, depending on the life of the significant parts
Buildings and improvements	15-40 years
Communication equipment	5-10 years
Office furniture, fixtures and other equipment	5-20 years
Transportation equipment	5-10 years
Others	5-20 years

An item of utility plant and others is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising as a result of the derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of income in the period the asset is derecognized.

The asset's residual values, useful lives and methods of depreciation and amortization are reviewed, and adjusted prospectively if appropriate, at each reporting date to ensure that the residual values, periods and methods of depreciation and amortization are consistent with the expected pattern of economic benefits from items of utility plant and others.

Construction in Progress

Construction in progress is stated at cost, which includes cost of construction, plant and equipment, capitalized borrowing costs and other direct costs. Construction in progress is not depreciated until such time that the relevant assets are substantially completed and available for their intended use.

Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Capitalization of borrowing costs commences when the activities necessary to prepare the qualifying asset for its intended use or sale have been undertaken and expenditures and borrowing costs have been incurred. Borrowing costs are capitalized until the asset is substantially completed and available for its intended use.

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, as well as any exchange differences arising from any foreign currency denominated borrowings used to finance the projects, to the extent that they are regarded as an adjustment to interest costs.

All other borrowing costs are expensed as incurred.

Asset Retirement Obligations

Under the terms of certain lease contracts, the *MERALCO Group* is required to dismantle the installations made in leased sites and restore such sites to their original condition at the end of the term of the lease. The *MERALCO Group* recognizes a liability measured at the present value of the estimated costs of these obligations and capitalizes such costs as part of the balance of the related item of utility plant and others and investment properties. The amount of asset retirement obligations is accreted and such accretion is recognized as interest expense.

Assets Funded by Customers

In accordance with the Distribution Services and Open Access Rule ("*DSOAR*"), the costs of non-standard connection facilities to connect the customers to *MERALCO*'s distribution network and to provide the customers with ongoing access to the supply of electricity are funded by the customers. *MERALCO* assesses whether the constructed or acquired non-standard connection facilities meet the definition of an asset in accordance with *PAS 16*. If the definition of an asset is met, *MERALCO* recognizes such asset at its acquisition or construction cost with an equivalent credit to the liability account. Such liability to the customers is included under "Other noncurrent liabilities" account in the consolidated statement of financial position, and is recognized as income over the expected useful life of the underlying asset. Net assets funded by customers do not form part of *MERALCO*'s regulatory asset base until amount are fully refunded.

Net Over-recoveries of Pass-through Charges

Transmission and *SL* over-recoveries which result from the difference in the power suppliers' billings and recovery of such pass-through costs from consumers are included in "Other noncurrent liabilities" account in the consolidated statements of financial position.

Investments in Associates and Interests in Joint Ventures

An associate is an entity where *MERALCO Group* has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but has no control or joint control over those policies.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed

sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries.

Investments in associates and interests in joint ventures are accounted for using the equity method of accounting and are initially recognized at cost.

Under the equity method, the investment in an associate or interest in a joint venture is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The consolidated statement of income reflects the *MERALCO Group*'s share of the results of operations of the associate or joint venture. Any change in the *OCI* of those investees is presented as part of the *MERALCO Group*'s *OCI*. In addition, when there has been a change recognized directly in the equity of the associate or joint venture, the *MERALCO Group* recognizes its share of any changes, when applicable, in the consolidated statement of changes in equity. Unrealized gains and losses resulting from transactions between the *MERALCO Group* and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The aggregate of the *MERALCO Group*'s share in profit or loss of an associate and a joint venture is shown on the face of the consolidated statement of income and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate or joint venture.

The financial statements of the associate or joint venture are prepared for the same reporting period as the *MERALCO Group*. When necessary, adjustments are made to bring the accounting policies in line with those of the *MERALCO Group*.

After application of the equity method, the *MERALCO Group* determines whether it is necessary to recognize an impairment loss on its investment in associate or interest in joint venture. At each reporting date, the *MERALCO Group* determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the *MERALCO Group* calculates the amount of impairment as the difference between the recoverable amount of the investment in associate or interest in joint venture and its carrying value, then recognizes the loss as part of equity in net earnings of an associate and a joint venture in the consolidated statement of income.

Upon loss of significant influence over the associate or joint control over the joint venture, the *MERALCO Group* measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the investment in associate or interest in joint venture upon loss of significant influence or joint control and the fair value of the retained investment and proceeds from disposal is recognized in profit or loss.

Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition-date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the *MERALCO Group* elects whether to measure the non-controlling interest in the acquiree at fair value

or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs in a business combination are expensed.

When a business is acquired, an assessment is made of the identifiable assets acquired and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic and other pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquirer's previously held equity interest in the acquiree is remeasured at fair value as at acquisition date and any resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration, which is deemed to be an asset or liability will be recognized in accordance with *PAS 39* in profit or loss. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the previously held equity interest in the acquiree, over the fair value of net identifiable assets acquired. If the difference is negative, such difference is recognized as gain in the consolidated statement of income.

If the initial accounting for a business combination is incomplete by the end of the reporting date in which the business combination occurs, the provisional amounts of the items for which the accounting is incomplete are reported in the consolidated financial statements. During the measurement period, which shall be no longer than one (1) year from the acquisition date, the provisional amounts recognized at acquisition date are retrospectively adjusted to reflect new facts and circumstances obtained that existed as at the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, additional assets or liabilities are also recognized if new information is obtained about facts and circumstances that existed as at the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as at that date.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from acquisition date, allocated to each of the cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units, beginning on the acquisition date.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of, is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in such circumstance is measured based on relative values of the operation disposed and the portion of the cash-generating unit retained.

Business combinations involving entities under common control are accounted for similar to the pooling-of-interests method. The assets and liabilities of the combining entities are reflected at their carrying amounts reported in the consolidated financial statements of the controlling company. Any difference between the consideration paid and the share capital of the "acquired" entity is reflected within equity as additional paid-in capital. The consolidated statement of income reflects the results

of the combining entities for the full period, irrespective of when the combination takes place. Comparatives are presented as if the entities had always been combined since the date the entities were under common control.

Investment Properties

Investment properties, except land, are stated at cost, net of accumulated depreciation and accumulated impairment loss, if any. The carrying amount includes transaction costs and costs of replacing part of an existing investment property at the time such costs are incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property.

Investment properties include properties that are being constructed or developed for future use.

Land classified as investment property is carried at cost less any impairment in value.

The *MERALCO Group*'s investment properties acquired before January 1, 2004 are stated at deemed cost. See *Note 15 – Equity* for the related discussions.

Investment properties, except land, are being depreciated on a straight-line basis over the useful life of 40 years.

Investment properties are derecognized either when they have been disposed of or when these are permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss from the derecognition of the investment properties is recognized in the consolidated statement of income in the period these are disposed or retired.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by the end of owner-occupation or the commencement of an operating lease to another party. If owner-occupied property becomes an investment property, the *MERALCO Group* accounts for such property in accordance with the policy stated under utility plant and others up to the date of the change in use. Transfers are made from investment property when, and only when, there is a change in use, evidenced by the commencement of owner-occupation or the commencement of development with a view to sale. Transfers from investment property are recorded using the carrying amount of the investment property as at the date of change in use.

Intangible Assets

Intangible assets acquired separately are initially measured at cost. Following initial recognition, intangible assets are carried at cost less accumulated amortization and any accumulated impairment loss. The useful lives of intangible assets are assessed at the individual asset level as having either finite or indefinite useful lives.

Intangible assets with finite lives are amortized over the useful economic lives of five (5) to 10 years using the straight-line method and assessed for impairment whenever there is an indication that the intangible assets may be impaired. At a minimum, the amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at each reporting date. Changes in the expected useful life or the expected consumption pattern of future economic benefit embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated as change in accounting estimates. The amortization expense of intangible assets with finite lives is recognized in the consolidated statement of income.

Intangible assets with indefinite useful lives are not amortized, but are assessed for impairment annually either individually or at the cash-generating unit level. The assessment of indefinite useful life is done annually at every reporting date to determine whether such indefinite useful life continues to exist. Otherwise, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognized in the consolidated statement of income.

Intangible assets generated within the business are not capitalized and expenditures are charged to profit or loss in the period these are incurred.

Fair Value Measurement

The *MERALCO Group* measures financial instruments at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either (a) in the principal market for the asset or liability, or (b) in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible to the *MERALCO Group*.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a nonfinancial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The *MERALCO Group* uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

i. Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
ii. Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and
iii. Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the *MERALCO Group* determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting date.

For the purpose of fair value disclosures, the *MERALCO Group* has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy.

Impairment of Nonfinancial Assets

The *MERALCO Group* assesses at each reporting date whether there is an indication that a nonfinancial asset (utility plant and others, intangible assets, investment properties, investments in associates and interests in joint ventures, receivable from the Bureau of Internal Revenue *("BIR"),* and net under-recoveries of pass-through charges), other than goodwill and intangible assets with indefinite useful life, may be impaired. If any such indication exists, the *MERALCO Group* makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an individual asset's or a cash generating unit's fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The fair value is the amount obtainable from the sale of the asset in an arm's-length transaction. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation factors/parameters, quoted share prices for publicly traded securities or other available fair value indicators. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in the consolidated statement of income.

An assessment is also made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If any such indication exists, the *MERALCO Group* estimates the individual asset's or cash generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If a reversal of impairment loss is to be recognized, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior periods. Such reversal is recognized in the consolidated statement of income. After such reversal, the depreciation and amortization expense are adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Intangible assets with indefinite useful lives are tested for impairment annually at every reporting date or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired, either individually or at the cash generating unit level, as appropriate. The amount of impairment is calculated as the difference between the recoverable amount of the intangible asset and its carrying amount. The impairment loss is recognized in the consolidated statement of income. Impairment losses relating to intangible assets may be reversed in future periods.

Goodwill is reviewed for impairment annually at every reporting date or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash generating unit or group of cash generating units, to which the goodwill relates. Where the recoverable amount of the cash generating unit or group of cash generating units is less than the carrying amount of the cash generating unit or group of cash generating units to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill shall not be reversed in future periods.

If the allocation of goodwill acquired in a business combination to cash generating units or group of cash generating units is incomplete, an impairment testing of goodwill is only carried out when

impairment indicators exist. Where impairment indicators exist, impairment testing of goodwill is performed at a level at which the acquirer can reliably test for impairment.

Financial Assets

Initial Recognition

Financial assets are classified as at *FVPL*, loans and receivables, *HTM* investments, *AFS* financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of financial assets is determined at initial recognition and, where allowed and appropriate, re-evaluated at each reporting date.

Financial assets are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets, except for financial instruments measured at *FVPL*.

Purchases or sales of financial assets that require delivery of assets within a timeframe established by regulation or convention in the market place (regular way purchase) are recognized on the trade date, which is the date the *MERALCO Group* commits to purchase or sell the asset.

The *MERALCO Group*'s financial assets include cash and cash equivalents, trade and non-trade receivables, advance payments to a supplier, advances to an associate, short-term investments, investments in Unit Investment Trust Funds ("*UITF*s"), investments in government securities and quoted and unquoted equity securities.

Subsequent Measurement

The subsequent measurement of financial assets depends on the classification as follows:

Financial Assets at FVPL

Financial assets at *FVPL* include financial assets held-for-trading and financial assets designated upon initial recognition as at *FVPL*. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivative assets, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments.

Financial assets may be designated at initial recognition as at *FVPL* if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on them on a different basis; (ii) the financial assets are part of a group of financial assets, which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial assets contain one (1) or more embedded derivatives that would need to be recorded separately.

Financial assets at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses on fair value changes recognized in the consolidated statement of income under "Interest and other financial income" or "Interest and other financial charges" accounts. Interest earned and dividends received from investment at *FVPL* are also recognized in the consolidated statement of income under "Interest and other financial income" account.

Derivatives embedded in host contracts are accounted for as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. These embedded derivatives are measured at fair value with gains and losses

arising from changes in fair value recognized in the consolidated statement of income. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such financial assets are carried at amortized cost using the effective interest method. This method uses an effective interest rate that discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset. Gains or losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as when these are amortized. Interest earned or incurred is recorded in "Interest and other financial income" or "Interest and other financial charges" accounts, in the consolidated statement of income. Assets in this category are included under current assets except assets with maturities beyond 12 months from reporting date, which are classified as noncurrent assets.

HTM Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as *HTM* when the *MERALCO Group* has the positive intention and ability to hold these assets to maturity. After initial measurement, *HTM* investments are measured at amortized cost using the effective interest method. Gains or losses are recognized in the consolidated statement of income. Assets in this category are included in the current assets except for maturities beyond 12 months from the reporting date, which are classified as noncurrent assets.

AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as *AFS* or are not classified in any of the three (3) foregoing categories. They are purchased and held indefinitely and may be sold in response to liquidity requirements or changes in market conditions. After initial measurement, *AFS* financial assets are measured at fair value with unrealized gains or losses recognized in *OCI* until the investment is derecognized, at which time the cumulative gain or loss recorded in *OCI* is recognized in the consolidated statement of income, or determined to be impaired, at which time the cumulative loss recorded in *OCI* is recognized in the consolidated statement of income. Interest earned from *AFS* debt securities is included under "Interest and other financial income" account in the consolidated statement of income. Dividends earned from *AFS* equity are likewise recognized in the consolidated statement of income under "Interest and other financial income" account when the right to receive payment has been established. These are included under noncurrent assets unless there is an intention to dispose of the investment within 12 months from the reporting date.

Financial Liabilities

Initial Recognition

Financial liabilities are classified as financial liabilities at *FVPL*, other financial liabilities, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of the financial liability is determined at initial recognition.

Financial liabilities are recognized initially at fair value inclusive of directly attributable transaction costs, except for financial liabilities at *FVPL*.

The *MERALCO Group*'s financial liabilities include notes payable, interest-bearing long-term financial liabilities, trade payables and other current liabilities [excluding output value added tax

("*VAT*"), accrued taxes, reinsurance liabilities and deferred lease income], customers' deposits, refundable service extension costs, and customers' refund.

Subsequent Measurement

The subsequent measurement of financial liabilities depends on their classification as follows:

Financial Liabilities at FVPL

Financial liabilities at *FVPL* include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as at *FVPL*. Financial liabilities are classified as held-for-trading if they are incurred for the purpose of repurchasing in the near term. Derivative liabilities, including separated embedded liabilities are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial liabilities at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses recognized in the consolidated statement of income under "Interest and other financial income" or "Interest and other financial charges" accounts. Interest incurred on financial liabilities designated as at *FVPL* is recognized in the consolidated statement of income under "Interest and other financial charges" account.

Financial liabilities may be designated at initial recognition as at *FVPL*, if any of the following criteria is met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different bases; (ii) the financial liabilities are part of a group of financial liabilities which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liabilities contain one (1) or more embedded derivatives that would need to be recorded separately.

The *MERALCO Group* does not have financial liabilities designated as at *FVPL* as at June 30, 2018 and December 31, 2017.

Other Financial Liabilities

After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as when these are amortized. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are integral part of the effective interest rate. The effective interest amortization is included under "Interest and other financial charges" account in the consolidated statement of income.

Derivative Financial Instruments

Initial Recognition and Subsequent Measurement

Derivative instruments, including separated embedded derivatives, are initially recognized at fair value on the date at which a derivative transaction is entered into or separated, and are subsequently re-measured at fair value. Changes in fair value of derivative instruments, other than those accounted for as effective hedges, are recognized immediately in the consolidated statement of income. Changes in fair value of derivative instruments accounted for as effective hedges are recognized in *OCI*. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The *MERALCO Group* does not have derivatives accounted for under hedge accounting.

An embedded derivative is separated from the hybrid or combined contract if all the following conditions are met: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the hybrid instrument is not recognized as at *FVPL*.

Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed.

See *Note 26 – Financial Assets and Financial Liabilities.*

Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if there is a currently enforceable legal right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The *MERALCO Group* assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the *MERALCO Group* and all of the counterparties.

Amortized Cost of Financial Instruments

Amortized cost is computed using the effective interest method less any allowance for impairment and principal repayment, plus or minus the cumulative amortization of premium or discount. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of effective interest.

'Day 1' Profit or Loss

Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the *MERALCO Group* recognizes the difference between the transaction price and fair value ('Day 1' profit or loss) in the consolidated statement of income, unless it qualifies for recognition as some other type of asset or liability. In cases where data used are not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the *MERALCO Group* determines the appropriate method of recognizing the 'Day 1' profit or loss amount.

Impairment of Financial Assets

The *MERALCO Group* assesses at each reporting date whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one (1) or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtor or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization

and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial Assets Carried at Amortized Cost

For financial assets carried at amortized cost, the *MERALCO Group* first assesses whether objective evidence of impairment exists individually. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment based on historical loss experience. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. *MERALCO* and *CEDC* consider termination or disconnection of service and significant financial difficulties of debtors as objective evidence that a financial asset or group of financial assets is impaired. For both specific and collective assessments, any deposits, collateral and credit enhancement are considered in determining the amount of impairment loss.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). If a loan is subject to variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The carrying amount of the asset is reduced either directly or through the use of an allowance account and the amount of the loss is recognized in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. The financial asset together with associated allowance is written off when there is no realistic prospect of future recovery and all collateral or deposits have been realized or have been transferred to the *MERALCO Group*.

If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If an asset written off is recovered, the recovery is recognized in the consolidated statement of income. Any reversal of an impairment loss is recognized in the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

AFS Financial Assets

In the case of equity instruments classified as *AFS*, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. When a decline in the fair value of an *AFS* financial asset has been recognized in *OCI* and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in *OCI* is reclassified from equity to profit or loss even though the financial asset has not been derecognized. The amount of the cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on the financial asset previously recognized in profit or loss. Impairment losses recognized in profit or loss for investment in equity instruments are not reversed in the consolidated statement of income. Subsequent increases in fair value after impairment are recognized directly in *OCI*.

In the case of debt instruments classified as *AFS*, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose

of measuring impairment loss. Such accrual is recorded as part of "Interest and other financial income" in the consolidated statement of income. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed in the consolidated statement of income.

Assets Carried at Cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Derecognition of Financial Instruments

Financial Assets

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the right to receive cash flows from the asset has expired;
- the *MERALCO Group* has transferred its right to receive cash flows from the asset or has assumed an obligation to receive cash flows in full without material delay to a third party under a "pass-through" arrangement; and
- either the *MERALCO Group* (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the *MERALCO Group* has transferred its right to receive cash flows from an asset or has entered into a "pass-through" arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, a new asset is recognized to the extent of the *MERALCO Group*'s continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the *MERALCO Group* could be required to repay.

Financial Liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the carrying amount of a financial liability extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed is recognized in the consolidated statement of income.

Redeemable Preferred Stock

MERALCO's peso-denominated redeemable preferred stock has characteristics of a liability and is thus recognized as a liability in the consolidated statement of financial position. The corresponding dividends on those shares are recognized as part of "Interest and other financial charges" account in the consolidated statement of income. Dividends no longer accrue when such shares have been called for redemption.

Inventories

Inventories are stated at the lower of cost or net realizable value. Costs of acquiring materials and supplies including costs incurred in bringing each item to their present location and condition are accounted using the moving average cost method. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost to sell or the current replacement cost of the asset.

VAT

Input *VAT* pertains to the 12% indirect tax paid in the course of trade or business on purchases of goods or services.

Output *VAT* pertains to the 12% tax due on the local sale of goods or services.

If at the end of any taxable month, the output *VAT* exceeds the input *VAT*, the outstanding balance is included under "Trade payables and other current liabilities" account. If the input *VAT* exceeds the output *VAT*, the excess shall be carried over to the succeeding months and included under "Other current assets" account.

Provisions

Provisions are recognized when the *MERALCO Group* has a present obligation, legal or constructive, as a result of a past event, and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the *MERALCO Group* expects a provision, or a portion, to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liabilities.

Retirement Benefits

MERALCO and certain subsidiaries have distinct, funded, noncontributory defined benefit retirement plans covering all permanent employees. *MERALCO*'s retirement plan provides for post-retirement benefits in addition to a lump sum payment to employees hired as at December 31, 2003. Retirement benefits for employees of *MERALCO* hired beginning January 1, 2004 were amended to provide for a defined lump sum payment only upon retirement of qualified employees. *MERALCO* also has a contributory provident plan introduced in January 2009 whereby employees hired beginning January 1, 2004 may elect to participate.

The net defined benefit liability or asset of the retirement plan is the aggregate of the present value of the defined benefit obligation at the end of the reporting period reduced by the fair value of plan

assets (if any), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method.

Defined benefit costs comprise of (i) service costs; (ii) net interest on the net defined benefit liability or asset; and (iii) remeasurements of the net defined benefit liability or asset.

Service costs, which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in the consolidated statement of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time, which is determined by applying the discount rate based on government bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in the consolidated statement of income.

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in *OCI* in the period in which they arise. Remeasurements are not reclassified to profit or loss in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the creditors of the *MERALCO Group*, nor can they be paid directly to the *MERALCO Group*. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations). If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The *MERALCO Group*'s right to be reimbursed for some or all of the expenditures required to settle a defined benefit obligation is recognized as a separate asset at fair value when, and only when, reimbursement is virtually certain.

The retirement costs under the defined contribution plan are recorded based on *MERALCO*'s contribution to the defined contribution plan as services are rendered by the employee.

Termination Benefits

Termination benefits are employee benefits provided in exchange for its severance as a result of either an entity's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept an offer of benefits in exchange for the termination of employment.

A liability and expense for a termination benefit is recognized at the earlier of when the entity can no longer withdraw the offer of those benefits and when the entity recognizes related restructuring costs.

Initial recognition and subsequent changes to termination benefits are measured in accordance with the nature of the employee benefit, as either post-employment benefits, short-term employee benefits, or other long-term employee benefits.

Employee Leave Entitlements

Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled wholly before 12 months after the end of the reporting period is recognized for services rendered by employees up to the end of the reporting period.

Unused sick leaves are accumulated, up to a certain limit, and commuted to cash upon separation or retirement. An actuarial valuation of the obligations on the accumulated unused sick leaves is conducted periodically in accordance with the relevant accounting standards.

Long-term Incentive Plan

The liability relating to the long-term incentive plan comprises the present value of the obligation at the end of the reporting date.

Equity

Common stock is measured at par value for all shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown as a deduction from equity, net of any related tax. The amount of proceeds and/or fair value of consideration received, net of incremental costs incurred directly attributable to the issuance of new shares in excess of par value, is recognized as additional paid-in capital.

Employee stock purchase plan cost represents the cumulative compensation expense recognized based on the amount determined using an option pricing model.

Change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction and presented as "Equity reserve" in the consolidated statement of financial position.

OCI comprises items of income and expense, which are not recognized in profit or loss as required or permitted by *PFRS*.

Retained earnings include net income attributable to the equity holders of the Parent, reduced by dividends declared on common stock. Dividends are recognized as a liability and deducted from retained earnings when they are declared. Dividend declarations approved after the financial reporting date are disclosed as events after the financial reporting date.

Non-controlling interests represent the equity interests in *MIESCOR* and subsidiaries, *CEDC* and subsidiary, *AMPSI*, *Comstech* and subsidiary, *Fieldtech* and *Bayad Center*, which are not held by *MERALCO*.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits associated with the transaction will flow to the *MERALCO Group* and the revenue can be reliably measured. In addition, collectibility is reasonably assured and the delivery of the goods or rendering of the service has occurred. The *MERALCO Group* assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The *MERALCO Group* concluded that it is acting as

principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

Sale of Electricity

Revenues are recognized upon supply of power to the customers and are stated at amounts invoiced to customers, inclusive of pass-through components, and net of discounts and/or rebates. The Uniform Filing Requirements ("*UFR*") on the rate unbundling released by the *ERC* on October 30, 2001 specified the following bill components: (a) generation charge, (b) transmission charge, (c) *SL* charge, (d) distribution charge, (e) supply charge, (f) metering charge, (g) Currency Exchange Rate Adjustment ("*CERA*") I and II, where applicable and (h) inter-class rate and lifeline subsidies. *VAT*, business taxes such as *LFT*, the Power Act Reduction (for residential customers) adjustment, universal charges, and Feed-in-Tariff - Allowance ("*FiT-All*") are also separately presented in the customer's billing statement. *VAT* and business taxes (billed and collected on behalf of the national and local governments, respectively) and universal charges and *FiT-All* [billed and collected on behalf of *PSALM* and National Transmission Corporation ("*TransCo*"), respectively] do not form part of *MERALCO* and *CEDC*'s revenues. Revenues are adjusted for the estimated over and/or under-recoveries of pass-through charges.

Sale of Services

Revenues from construction contracts are recognized based on the percentage-of-completion method of accounting and is measured principally on the basis of the estimated completion of a physical proportion of the contract work with reference to the actual costs incurred to date over the estimated total costs of the project. Revenue from contracts to manage, supervise or coordinate construction activity for others and contracts where materials and services are supplied by project owners are recognized only to the extent of the contracted fees.

Contract costs principally include subcontracted costs related to contract performance. Expected losses on contracts are recognized immediately when it is probable that the total contract costs will exceed total contract revenues. The amount of such loss is determined irrespective of whether or not work has commenced on the contract; the stage of completion of contract activity; or the amount of profits expected to arise on other contracts, which are not treated as a single construction contract. Changes in contract performance, contract conditions and estimated profitability, including those arising after final contract settlements and after gross margins are recognized in the period in which the changes are determined.

Service and consulting fees are recognized when services are rendered.

Interest Income

Revenue is recognized as interest accrues, using the effective interest method. The effective interest rate is the rate that discounts estimated future cash receipts through the expected life of the financial instrument.

Dividends

Revenue is recognized when the *MERALCO Group*'s right to receive the payment is established.

Lease Income

Income arising from lease of investment properties and pole positions is accounted for on a straight-line basis over the lease term.

Lease income is included under "Revenues – Sale of other services" account in the consolidated statement of income.

Cost and Expense Recognition

Expenses are decreases in economic benefits during the financial reporting period in the form of outflows or decrease of assets or incurrence of liabilities that result in decrease in equity, other than those relating to distributions to equity participants. These are recognized when incurred.

Contract costs principally include all direct materials, labor costs and indirect costs related to contract performance. Expected losses on contracts are recognized immediately when it is probable that the total contract cost will exceed total contract revenue. The amount of such loss is determined irrespective of whether or not work has commenced on the contract, the stage of completion of the contract activity, or the amount of profits expected to arise on other contracts which are not treated as a single contruction contract. Changes in contract performance, contract conditions and estimated profitability, including those arising from contract penalty provisions, and final contract settlements which may result in revisions to estimated cost and gross margins are recognized in the year in which the changes are determined.

Total contract costs incurred and estimated earnings recognized in excess of total billings are recognized as an asset.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or the arrangement conveys a right to use the asset.

Company as Lessee

Operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease term.

Company as Lessor

Leases where the *MERALCO Group* does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Foreign Currency-Denominated Transactions and Translations

The consolidated financial statements are presented in Philippine peso, which is also *MERALCO*'s functional and presentation currency. The Philippine peso is the currency of the primary economic environment in which the *MERALCO Group* operates, except for *LOIL* and *MPG Asia*. This is also the currency that mainly influences the revenue from and cost of rendering services. Each entity in the *MERALCO Group* determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

The functional currency of *LOIL* and *MPG Asia* is the United States ("*U.S.*") dollar.

Transactions in foreign currencies are initially recorded in the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated using functional currency closing rate of exchange prevailing at the end of the reporting date. All differences are recognized in the consolidated statement of income except for foreign exchange differences that relate to capitalizable borrowing costs on qualifying assets. Nonmonetary items that are measured in terms of historical cost in foreign currency are translated using the exchange rate as at the date of the initial transactions.

As at the reporting date, the monetary assets and liabilities of subsidiaries, *LOIL* and *MPG Asia* whose functional currency is other than Philippine peso, are translated into Philippine peso at the rate of exchange prevailing at the end of the reporting date, and income and expenses are translated monthly using the weighted average exchange rate for the month. The exchange differences arising on translation are recognized as a separate component of *OCI* as cumulative translation adjustments. On the disposal of a subsidiary, the amount of cumulative translation adjustments recognized in *OCI* is recognized in the consolidated statement of income.

Income Taxes

Current Income Tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authority. The tax rate and tax laws used to compute the amount are those that are enacted or substantively enacted as at the reporting date.

Deferred Income Tax

Deferred income tax is provided on all temporary differences at the reporting date between the income tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized except:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax assets to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent these have become probable that future taxable profit will allow the deferred income tax assets to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the periods when the assets are realized or the liabilities are settled, based on tax rates and tax laws that are enacted or substantively enacted as at the reporting date.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current income tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Deferred income tax items are recognized in correlation to the underlying transaction either in profit or loss or directly in equity.

Earnings per Share

Basic earnings per share is calculated by dividing the net income for the period attributable to equity holders of the parent by the weighted average number of common shares outstanding during the period.

Diluted earnings per share is calculated by dividing the net income for the period attributable to equity holders of the parent by the weighted average number of shares outstanding, adjusted for the effects of any dilutive potential common shares.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. These are disclosed in the notes to consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized unless the realization of the assets is virtually certain. These are disclosed in the notes to consolidated financial statements when an inflow of economic benefits is probable.

Events After the Reporting Date

Post reporting date events that provide additional information about the *MERALCO Group*'s financial position at the reporting date (adjusting events) are reflected in the consolidated financial statements. Post reporting date events that are non-adjusting events are disclosed in the notes to consolidated financial statements, when material.

5. Management's Use of Significant Judgments, Accounting Estimates and Assumptions

The preparation of the *MERALCO Group*'s consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent assets and liabilities, at the end of the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Judgments

In the process of applying the *MERALCO Group*'s accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements.

Determination of Functional Currency

The functional currencies of the entities under the *MERALCO Group* are the currencies of the primary economic environment in which each entity operates. It is the currency that mainly influences the revenue and cost of rendering services.

Based on the economic substance of the underlying circumstances, the functional and presentation currency of *MERALCO* and its subsidiaries, except *LOIL* and *MPG Asia*, is the Philippine peso. The functional and presentation currency of *LOIL* and *MPG Asia* is the U.S. dollar.

Operating Lease Commitments

As Lessor

The *MERALCO Group* has several lease arrangements as a lessor. Based on the terms and conditions of the arrangements, it has evaluated that the significant risks and rewards of ownership of such properties are retained by the *MERALCO Group*. The lease agreements do not transfer ownership of the assets to the lessees at the end of the lease term and do not give the lessees a bargain purchase option over the assets. Consequently, the lease agreements are accounted for as operating leases.

As Lessee

As a lessee, the *MERALCO Group* has commercial lease arrangements covering certain office spaces, payment offices and substation sites and towers. The *MERALCO Group* has determined, based on the evaluation of the terms and conditions of the arrangements, that it has not acquired any significant risks and rewards of ownership of such properties because the lease arrangements do not transfer to the *MERALCO Group* the ownership over the assets at the end of the lease term and do not provide the *MERALCO Group* a bargain purchase option over the leased assets. Consequently, the lease agreements are accounted for as operating leases.

Arrangement that Contains a Lease

MERALCO's Purchased Power Agreements ("*PPAs*") and Power Supply Agreements ("*PSAs*") with certain power generating companies qualify as leases on the basis that *MERALCO* and these power generating companies have 'take or pay' ("*ToP*") arrangements where payments for purchased power or for contracted capacity are made on the basis of the availability of the power plant and not based solely on actual consumption. In determining the lease classification, it is judged that substantially all the risks and rewards incident to the ownership of the power plants are with these power generating companies. Thus, the *PPA*s and *PSA*s are classified as operating leases. Accordingly, capacity fees,

fixed operating and maintenance fees, and transmission line fees that form part of purchased power expense are accounted for similar to a lease.

Components of purchased power, which have been accounted for similar to a lease, amounted to ₱25,019 million and ₱23,953 million for the six months ended June 30, 2018 and 2017, respectively. These are recognized as "Purchased Power" in the consolidated statements of income.

See *Note 23 – Purchased Power*.

Entity in which the MERALCO Group Holds more than the Majority of the Voting Rights Accounted for as a Joint Venture

MERALCO, through *MGen*, has a 51% interest in San Buenaventura Power Ltd. Co. ("*SBPL*"). While *MERALCO* owns majority of the voting rights in *SBPL,* it does not have sole control over *SBPL*. *MERALCO's* investment in *SBPL* is accounted for as a joint venture since key operating and financial decisions of *SBPL* require the unanimous vote and consent of the parties sharing control.

Entity in which the MERALCO Group Holds less than 20% of the Voting Rights Accounted for as an Associate

MERALCO, through *MGen*, has a 14% interest in Global Business Power Corporation ("*GBPC"). GBPC* is considered an associate and, thus, *MERALCO*'s interest in *GBPC* is accounted for using the equity method as *MERALCO* is deemed to have significant influence in *GBPC* as evidenced by its representation in the *BOD* and Executive Committee and the provision of essential technical information to *GBPC*. This representation guarantees *MGen*'s participation in the decision making acts and policy making process of *GBPC*.

MERALCO, through *Finserve*, has 10% interest in AF Payments, Inc. ("*AF Payments*"). *AF Payments* is considered an associate and, thus, *MERALCO/Finserve*'s interest in *AF Payments* is accounted for using the equity method as *MERALCO/Finserve* is deemed to have significant influence as evidenced by its representation in the *BOD* which guarantees *MERALCO*'s participation in the decision making and policy making process of *AF Payments*.

Contingencies

The *MERALCO Group* has possible claims from or obligation to other parties from past events and whose existence may only be confirmed by the occurrence or non-occurrence of one (1) or more uncertain future events not wholly within its control. Management has determined that the present obligations with respect to contingent liabilities and claims with respect to contingent assets do not meet the recognition criteria, and therefore has not recorded any such amounts.

See *Note 28 – Contingencies and Legal Proceedings*.

Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty as at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial reporting date are discussed as follows:

Estimating Useful Lives of Utility Plant and Others, Intangible Assets with Finite Lives and Investment Properties

The *MERALCO Group* estimates the useful lives of utility plant and others, intangible assets with finite lives and, investment properties based on the periods over which such assets are expected to be available for use. The estimate of the useful lives of the utility plant and others, intangible assets with finite lives and investment properties is based on management's collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful lives are reviewed at least at each financial reporting date and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limitations on the use of such assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought about by changes in the factors mentioned in the foregoing. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of utility plant and others, intangible assets with finite lives and investment properties would increase recorded operating expenses and decrease noncurrent assets.

The total depreciation and amortization expense of utility plant and others amounted to ₱3,333 million and ₱3,156 million for the six months ended June 30, 2018 and 2017, respectively. Total carrying values of utility plant and others, net of accumulated depreciation and amortization, amounted to ₱136,980 million and ₱133,874 million as at June 30, 2018 and December 31, 2017, respectively.

Total depreciation of investment properties amounted ₱3 million and ₱2 million for the six months ended June 30, 2018 and 2017, respectively. Total carrying values of investment properties, net of accumulated depreciation, amounted to ₱1,506 million and ₱1,509 million as at June 30, 2018 and December 31, 2017, respectively.

Total amortization of intangible assets with finite lives amounted to ₱279 million and ₱303 million for the six months ended June 30, 2018 and 2017, respectively. Total carrying values of intangible assets with finite lives, net of accumulated amortization, amounted to ₱2,095 million and ₱2,254 million as at June 30, 2018 and December 31, 2017, respectively.

See *Note 7 – Utility Plant and Others, Note 9 – Investment Properties* and *Note 10 – Other Noncurrent Assets*.

Impairment of Nonfinancial Assets

PFRS requires that an impairment review be performed when certain impairment indicators are present. These conditions include obsolescence, physical damage, significant changes in the manner by which an asset is used, worse than expected economic performance, drop in revenues or other external indicators, among others. In the case of goodwill, at a minimum, such asset is subject to an annual impairment test and more frequently whenever there is an indication that such asset may be impaired. This requires an estimation of the value in use of the cash generating unit to which the goodwill is allocated. Estimating the value in use requires preparation of an estimate of the expected future cash flows from the cash generating unit and choosing an appropriate discount rate in order to calculate the present value of those cash flows.

Determining the recoverable amount of utility plant and others, intangible assets, investment properties, investments in associates and interests in joint ventures, goodwill and other noncurrent assets, requires (i) the determination of future cash flows expected to be generated from the continued use as well as ultimate disposition of such assets and (ii) making estimates and assumptions that can materially affect the consolidated financial statements. Future events may cause management to

conclude that utility plant and others, intangible assets, investment properties, investments in associates and interests in joint ventures, goodwill and other noncurrent assets are impaired. Any resulting impairment loss could have material adverse impact on the *MERALCO Group*'s consolidated financial position and results of operations.

The preparation of estimated future cash flows involves significant estimations and assumptions. While management believes that the assumptions are appropriate and reasonable, significant changes in the assumptions may materially affect the assessment of recoverable values and may lead to future impairment charges under *PFRS*.

Provision for impairment loss on net under-recoveries of pass-through charges amounted to ₱4,436 million as at June 30, 2018 and December 31, 2017, respectively.

The carrying values of nonfinancial assets subject to impairment review are as follows:

Account	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
	(Amounts in millions)	
Utility plant and others	**₱136,980**	₱133,874
Investments in associates and interest in joint ventures	**11,943**	11,446
Net under-recoveries of pass-through charges	**7,331**	1,654
Intangible assets	**2,095**	2,254
Investment properties	**1,506**	1,509
Receivable from the *BIR*	**181**	181
Goodwill	**35**	35

See *Note 7 – Utility Plant and Others, Note 8 – Investments in Associates and Interests in Joint Ventures, Note 9 – Investment Properties and Note 10 – Other Noncurrent Assets.*

Goodwill

The *MERALCO Group*'s consolidated financial statements and the results of operations reflect acquired businesses after the completion of the respective acquisition. The *MERALCO Group* accounts for the acquisition of businesses using the acquisition method of accounting, which requires extensive use of accounting judgments and estimates to allocate the purchase price to the fair market values of the acquire's identifiable assets and liabilities and contingent liabilities, if any, at the acquisition date. Any excess in the purchase price over the estimated fair market values of the net assets acquired is recorded as goodwill in the consolidated statement of financial position. Thus, the number of items, which involves judgments made in estimating the fair market value to be assigned to the acquiree's assets and liabilities, can materially affect the *MERALCO Group*'s financial position.

Realizability of Deferred Tax Assets

The *MERALCO Group* reviews the carrying amounts of deferred tax assets at the end of each reporting period and reduces these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized.

Assessment on the recognition of deferred tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income for the subsequent reporting date. This forecast is

based on past results and future expectations on revenues and expenses as well as future tax planning strategies. Management believes that sufficient taxable profit will be generated to allow all or part of the recorded or recognized deferred tax assets to be utilized. The amounts of the deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised.

Based on the foregoing assessment, following are the relevant consolidated information with respect to deferred tax assets:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Recognized deferred tax assets	**₱27,951**	₱26,151
Unrecognized deferred tax assets	**663**	955

See *Note 27 – Income Taxes and Local Franchise Taxes*.

Determination of Fair Values of Financial Assets and Financial Liabilities

Where fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair values of financial instruments.

See *Note 26 – Financial Assets and Financial Liabilities*.

Estimating Allowance for Doubtful Accounts

If there is objective evidence that an impairment loss has been incurred in the trade and other receivables balance of the *MERALCO Group*, an estimate of the allowance for doubtful accounts related to trade and other receivables that are specifically identified as doubtful of collection is made. The amount of allowance is evaluated by management on the basis of factors that affect the collectability of the accounts. In such case, use of judgment based on the best available facts and circumstances, including but not limited to, the length of the *MERALCO Group*'s relationship with the customer and the customer's credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due in order to reduce the *MERALCO Group*'s receivables to amounts that management expects to collect is applied. These specific reserves are re-evaluated and adjusted as additional information received affect the amounts estimated.

In addition to specific allowance against individually significant receivables, an assessment for collective impairment allowance against credit exposures of the customers, which were grouped based on common credit characteristics, although not specifically identified as requiring a specific allowance, have a greater risk of default than when the receivables were originally granted to customers is done. This collective allowance is based on historical loss experience using various factors, such as historical performance of the customers within the collective group, deterioration in the markets in which the customers operate, and identified structural weaknesses or deterioration in the cash flows of customers.

Total asset impairment provision for trade and other receivables, net of recoveries, recognized in the consolidated statements of income amounted to ₱8 million and ₱6 million for the six months ended June 30, 2018 and 2017, respectively. Trade and other receivables, net of asset impairment, amounted to ₱27,670 million and ₱26,288 million as at June 30, 2018 and December 31, 2017, respectively.

See *Note 12 – Trade and Other Receivables.*

Estimating Net Realizable Value of Inventories

Inventories consist of materials and supplies used in the power distribution and services segments, and are valued at the lower of cost or net realizable value. The cost of inventories is written down whenever the net realizable value of inventories becomes lower than the cost due to damage, physical deterioration, obsolescence, and change in price levels or other causes. The lower of cost or net realizable value of inventories is reviewed on a periodic basis. Inventory items identified to be obsolete and no longer usable are written off and charged as expense in the consolidated statement of income.

The carrying values of inventories amounted to ₱3,447 million and ₱3,330 million as at June 30, 2018 and December 31, 2017, respectively.

See *Note 13 – Inventories*.

Estimation of Retirement Benefit Costs

The cost of defined benefit retirement plans and other post-employment benefits as well as the present value of the retirement obligation are determined using actuarial valuations. The actuarial valuation involves making various assumptions. These include the determination of the discount rates, future salary increases, mortality rates and future retirement benefits increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, defined benefit obligations are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date. The retirement and other post-employment benefits expense amounted to ₱550 million and ₱526 million for the six months ended June 30, 2018 and 2017, respectively. The retirement and other post-employment benefit liabilities as at June 30, 2018 and December 31, 2017 amounted to ₱4,803 million and ₱2,022 million, respectively.

In determining the appropriate discount rate, management considers the interest rates of government bonds in the respective currencies, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. The underlying bonds are further reviewed for quality, and those having excessive credit spreads are removed from the population of bonds on which the discount rate is based, on the basis that they do not represent high quality bonds.

The mortality rate is based on publicly available mortality tables for the specific country and is modified accordingly with estimates of mortality improvements. Future salary increases and retirement benefits increases are based on expected future inflation rates for the specific country.

See *Note 24 – Expenses and Income* and *Note 25 – Long-term Employee Benefits*.

Provisions

The *MERALCO Group* has various claims, assessments and cases as discussed in *Note 28 – Contingencies and Legal Proceedings*. The *MERALCO Group*'s estimate for probable costs for the resolution of these claims, assessments and cases has been developed in consultation with external, if

any, and internal counsels handling the defense in these claims, assessments and cases and is based upon thorough analysis of potential outcome.

The *MERALCO Group*, in consultation with its external legal counsels, does not believe that these claims and legal proceedings will have a material adverse effect on the consolidated financial statements. It is possible, however, that future financial performance could be materially affected by changes in the estimates or the effectiveness of management's strategies and actions relating to these proceedings.

The *MERALCO Group* recognized net provisions on various claims and assessments amounting to ₱4,673 million and ₱4,049 million for the six months ended June 30, 2018, and 2017, respectively.

See *Note 18 – Provisions* and *Note 21 – Trade Payables and Other Current Liabilities.*

Revenue Recognition

The *MERALCO Group*'s revenue recognition policies require the use of estimates and assumptions that may affect the reported amounts of its revenues and receivables.

Revenues from sale of electricity by *MERALCO* and *CEDC* are billed based on customer-specific billing cycle cut-off date for each customer, while recording of related purchased power cost in the accounts is based on calendar month as provided in the terms of the *PPA*s and *PSA*s. The recognition of unbilled revenues for billing cycles with earlier than month-end cut-off dates requires the use of estimates. The difference between the amounts initially recognized based on provisional invoices and the settlement of the actual billings by the generators is taken up in the subsequent period. Also, revenues from sale of electricity are adjusted for the estimated over and/or under-recoveries of pass-through charges, which are subject of various applications for recovery and approval by the *ERC*.

Management believes that such use of estimates will not result in material adjustments in future periods.

Revenues and costs from construction contracts of *MIESCOR* are recognized based on the percentage of completion method. This is measured principally on the basis of the estimated completion of a physical proportion of the contract work.

6. **Segment Information**

Each operating segment of the *MERALCO Group* engages in business activities from which revenues are earned and expenses are incurred (including revenue and expenses relating to transactions with other business segments within the *MERALCO Group*). The operating results of each of the operating segments are regularly reviewed by *MERALCO*'s Management Committee to determine how resources are to be allocated to the operating segments and to assess their performances for which discrete financial information is available.

For management purposes, the *MERALCO Group*'s operating businesses are organized and managed separately according to the nature of services provided, with each segment representing a strategic business unit that offers different products and/or services, as follows:

- Power

  The Power segment consists of (a) electricity distribution, (b) power generation and (c) *RES*.

  Electricity distribution – This is principally electricity distribution and supply of power on a pass-through basis covering all captive customers in the *MERALCO* and the *CEDC* franchise areas in Luzon. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s franchise area covers Clark Special Economic Zone and the sub-zone.

  Power generation – The *MERALCO Group'*s re-entry into power generation is through investments in operating companies or participation in the development of power generation projects. *MGen*, the power generation arm of the *MERALCO Group,* has a 14% equity interest in *GBPC*. *GBPC* owns a total of 854 MegaWatt ("*MW*") (gross) of coal and diesel-fired power plants.

  MGen owns an effective 28% equity in PacificLight Power Pte Ltd. ("*PacificLight Power*") in Jurong Island, Singapore. *PacificLight Power* owns and operates a 2 x 400 *MW* liquefied natural gas ("*LNG*") power plant which began commercial operations in February 2014.

  MGen, through *SBPL*, is constructing a 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon. The *PSA* with *MERALCO* was approved by the *ERC* on May 19, 2015. Target commercial operations date is third quarter of 2019.

  MGen is developing a 2 x 600 *MW* (net) ultra-supercritical pulverized coal-fired power plant in Atimonan, Quezon through *A1E*. A *PSA* has been executed between *A1E* and *MERALCO* for the full capacity. The regulatory hearing process at the *ERC* for the *PSA* had long been completed and *A1E* has filed its *FOE* on March 8, 2017. Evaluation of the short-listed Engineering, Procurement and Construction ("*EPC*") contractors is concluded and negotiations to finalize arguments with contractors are on going. *A1E* has also secured on Environmental Compliance Certificate ("*ECC*") and has been issued a Certificate of Registration as a preferred enterprise by the Board of Investments ("*BOI*"). The expected completion of the first unit is 2021 and the second 600 *MW* by early 2022.

  MGen is also developing (i) a 2 x 300 *MW* (net) Circulating Fluidized Bed ("*CFB*"), coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. ("*RP Energy*"), and (ii) a 2 x 350 *MW* (net) sub-critical pulverized coal-fired power plant in Calaca, Batangas through St. Raphael Power Generation Corporation ("*St. Raphael*"), and among others.

MGen has 49% equity interest in Mariveles Power Generation Corporation ("*Mariveles Power*") which is developing a 4 x 132 *MW* coal-fired power plant in Bataan.

MERALCO has 50% equity interest in *Pure Meridian*, which is primarily engaged in the development of various mini-hydroelectric power projects.

See *Note 8 – Investments in Associates and Interests in Joint Ventures.*

RES – This covers the sourcing and supply of electricity to qualified contestable customers. *MERALCO* and *CEDC* serve as a local retail electricity suppliers within their franchise area under a separate business unit, *MPower* and Cogent Energy, respectively. Under Retail Competition and Open Access ("*RCOA*"), qualified contestable customers who opt to switch to contestability and elects to be among contestable customers may source their electricity supply from any retail electricity supplier, including *MPower* and Cogent Energy.

The *ERC* granted the following subsidiaries distinct *RES* licenses to operate as retail electricity suppliers within Luzon and Visayas: *Vantage*, a wholly owned subsidiary of *MERALCO*; *Solvre*, a wholly owned subsidiary of *MGen*; *MeridianX*, a wholly owned subsidiary of *Comstech*, on January 10, 2017, February 9, 2017 and February 9, 2017, respectively. *Clarion*, a wholly owned subsidiary of *CEDC*, has submitted the requirements for its *RES* licensing to *ERC*. As at July 30, 2018, the approval of its *RES* licensing is pending with the *ERC*.

- Other Services

  The other services segment is involved principally in electricity-related services, such as; electro-mechanical engineering, construction, consulting and related manpower services, e-transaction and bills collection, telecoms services, rail-related operations and maintenance services, insurance and re-insurance, e-business development, power distribution management, and energy systems management and harnessing renewable energy. These services are provided by *MIESCOR*, *MBI* and *MLI* (collectively known as "*MIESCOR Group*"), *CIS*, *Bayad Center, CFSI and Fieldtech* (collectively referred to as "*CIS Group*"), *e-MVI*, *Paragon* and *Radius* (collectively referred to as "*e-MVI Group*"), *Comstech, MRail*, *RSIC*, *LOIL, Finserve*, *MServ*, *Spectrum* and *eSakay*.

The Management Committee monitors the operating results of each business unit separately for the purpose of determining resource allocation and assessing performance. Performance is evaluated based on (i) net income attributable to equity holders of the parent for the period, (ii) consolidated core earnings before interest, taxes, and depreciation and amortization ("consolidated core *EBITDA*"); and (iii) consolidated core net income ("*CCNI*"). Net income for the period is measured consistent with reported net income in the consolidated statement of income.

Consolidated core *EBITDA* is measured as *CCNI* excluding depreciation and amortization, interest and other financial charges, interest and other financial income, equity in net earnings or losses of associates and joint ventures and provision for income tax.

CCNI for the period is measured as consolidated net income attributable to equity holders of the parent adjusted for foreign exchange gain or loss, mark-to-market gain or loss, impairment or reversal of impairment of noncurrent assets and certain other non-recurring gain or loss, if any, net of tax effect of the foregoing adjustments.

Billings between operating segments are done on an arm's-length basis in a manner similar to transactions with third parties. Segment revenues, segment expenses and segment results include transfers among business segments. Those transfers are eliminated upon consolidation.

The *MERALCO Group* operates and generates substantially all of its revenues in the Philippines (i.e., one (1) geographical location). Thus, geographical segment information is not presented. The *MERALCO Group* has no revenues from transactions with a single external customer accounting for 10% or more of its revenues from external customers.

		Power		Other Services		Inter-segment Transactions		Total	
		For the Six Months Ended June 30							
	Note	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
		(Amounts in Millions)							
Revenues		**₱146,903**	₱137,409	**₱4,667**	₱4,464	**(₱1,026)**	(₱841)	**₱150,544**	₱141,032
Segment results		**₱17,962**	₱16,459	**₱1,154**	₱1,037	**₱–**	₱–	**₱19,116**	₱17,496
Depreciation and amortization		**(3,391)**	(3,271)	**(224)**	(191)	**–**	–	**(3,615)**	(3,462)
Interest and other financial income	*24*	**1,191**	1,061	**19**	14	**–**	–	**1,210**	1,075
Equity in net earnings (losses) of associates and joint ventures	*8*	**(138)**	269	**(8)**	(39)	**–**	–	**(146)**	230
Interest and other financial charges	*24*	**(992)**	(717)	**(42)**	(33)	**–**	–	**(1,034)**	(750)
Provision for income tax - net		**(3,264)**	(3,761)	**(270)**	(260)	**–**	–	**(3,534)**	(4,021)
Net income attributable to non-controlling interests		**–**	–	**–**	–	**(24)**	(67)	**(24)**	(67)
Net income attributable to equity holders of the Parent		**₱11,368**	₱10,040	**₱629**	₱528	**(₱24)**	(₱67)	**₱11,973**	₱10,501

		Power		Other Services		Inter-segment Transactions		Total	
		For the Three Months Ended June 30							
	Note	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
		(Amounts in Millions)							
Revenues		**₱77,894**	₱72,685	**₱2,424**	₱2,287	**(₱581)**	(₱516)	**₱79,737**	₱74,456
Segment results		**₱9,521**	₱8,858	**₱531**	₱532	**₱–**	₱–	**₱10,052**	₱9,347
Depreciation and amortization		**(1,739)**	(1,631)	**(113)**	(94)	**–**	–	**(1,852)**	(1,725)
Interest and other financial income	*24*	**605**	541	**11**	6	**–**	–	**616**	547
Equity in net earnings (losses) of associates and joint ventures	*8*	**(272)**	110	**(7)**	(17)	**–**	–	**(279)**	93
Interest and other financial charges	*24*	**(330)**	(361)	**(22)**	(18)	**–**	–	**(352)**	(379)
Provision for income tax - net		**(1,363)**	(2,065)	**(132)**	(142)	**–**	–	**(1,495)**	(2,207)
Net income attributable to non-controlling interests		**–**	–	**–**	–	**(29)**	(35)	**(29)**	(35)
Net income attributable to equity holders of the Parent		**₱6,422**	₱5,452	**₱268**	₱267	**(₱29)**	(₱35)	**₱6,661**	₱5,684

The inter-segment revenues mainly represent revenues of other services segment earned from the power segment.

The following table shows the reconciliation of the *EBITDA* to net income:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
EBITDA	**₱17,585**	₱17,215	**₱8,897**	₱9,293
Add (Deduct):				
Depreciation and amortization	**(3,615)**	(3,462)	**(1,852)**	(1,725)
Interest and other financial income	**1,210**	1,075	**616**	547
Interest and other financial charges	**(1,034)**	(750)	**(352)**	(379)
Equity in net earnings (losses) of associates and joint ventures	**(146)**	230	**(279)**	93
Foreign exchange gains	**1,531**	281	**1,155**	97
Income before income tax	**15,531**	14,589	**8,185**	7,926
Provision for income tax - net	**(3,534)**	(4,021)	**(1,495)**	(2,207)
Net income	**₱11,997**	₱10,568	**₱6,690**	₱5,719

The following table shows the reconciliation of the *CCNI* to net income:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
CCNI	**₱10,851**	₱10,118	**₱5,934**	₱5,520
Add (Deduct) non-core items, net of tax:				
Foreign exchange gains (losses)	**1,188**	223	**848**	(111)
Non-core income (expenses)	**(66)**	160	**(121)**	275
Net income for the period attributable to equity holders of the Parent	**11,973**	10,501	**6,661**	5,684
Net income for the period attributable to non-controlling interests	**24**	67	**29**	35
Net income	**₱11,997**	₱10,568	**₱6,690**	₱5,719

7. Utility Plant and Others

The movements in utility plant and others are as follows:

		June 30, 2018 (Unaudited)								
	Note	**Subtransmission and Distribution**	**Land**	**Buildings and Improvements**	**Communication Equipment**	**Office Furniture, Fixtures and Other Equipment**	**Transportation Equipment**	**Others**	**Construction in Progress**	**Total**
						(Amounts in millions)				
Cost:										
Balance at January 1, 2018		**₱167,843**	**₱15,361**	**₱6,501**	**₱2,726**	**₱3,243**	**₱3,530**	**₱4,592**	**₱13,974**	**₱217,770**
Additions		**464**	**6**	**2**	**81**	**25**	**189**	**181**	**5,532**	**6,480**
Disposals/retirements		**(355)**	**–**	**(36)**	**(39)**	**(419)**	**(106)**	**(15)**	**–**	**(970)**
Transfers from construction in progress		**1,846**	**–**	**182**	**14**	**–**	**1**	**4**	**(2,047)**	**–**
Reclassifications	*10*	**–**	**–**	**(4)**	**–**	**(9)**	**4**	**9**	**–**	**–**
Balance at June 30, 2018		**169,798**	**15,367**	**6,645**	**2,782**	**2,840**	**3,618**	**4,771**	**17,459**	**223,280**
Less accumulated depreciation and amortization:										
Balance at January 1, 2018		**72,626**	**–**	**2,745**	**1,232**	**2,497**	**2,233**	**2,563**	**–**	**83,896**
Depreciation and amortization		**2,697**	**–**	**89**	**111**	**141**	**141**	**154**	**–**	**3,333**
Disposals/retirements		**(355)**	**–**	**–**	**(39)**	**(419)**	**(102)**	**(14)**	**–**	**(929)**
Reclassifications		**–**	**–**	**(3)**	**–**	**(1)**	**2**	**2**	**–**	**–**
Balance at June 30, 2018		**74,968**	**–**	**2,831**	**1,304**	**2,218**	**2,274**	**2,705**	**–**	**86,300**
Net book value		**₱94,830**	**₱15,367**	**₱3,814**	**₱1,478**	**₱622**	**₱1,344**	**₱2,066**	**₱17,459**	**₱136,980**

		December 31, 2017 (Audited)								
	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
						(Amounts in millions)				
Cost:										
Balance at January 1, 2017		₱160,528	₱15,363	₱6,279	₱2,726	₱3,242	₱3,425	₱4,188	₱10,861	₱206,612
Additions		287	5	79	90	153	306	199	10,850	11,969
Disposals/retirements		(236)	(7)	–	(200)	(149)	(195)	(19)	–	(806)
Deconsolidation of a subsidiary	*3 and 8*	–	–	(10)	–	(4)	(6)	(15)	–	(35)
Transfers from construction in progress		7,264	–	135	85	–	–	253	(7,737)	–
Reclassifications	*10*	–	–	18	25	1	–	(14)	–	30
Balance at December 31, 2017		167,843	15,361	6,501	2,726	3,243	3,530	4,592	13,974	217,770
Less accumulated depreciation and amortization:										
Balance at January 1, 2017		67,164	–	2,593	1,301	2,306	2,212	2,222	–	77,798
Depreciation and amortization		5,680	–	191	203	301	276	278	–	6,929
Deconsolidation of a subsidiary		–	–	(9)	–	(4)	(3)	(13)	–	(29)
Disposals/retirements		(218)	–	(29)	(193)	(102)	(252)	(8)	–	(802)
Reclassifications		–	–	(1)	(79)	(4)	–	84	–	–
Balance at December 31, 2017		72,626	–	2,745	1,232	2,497	2,233	2,563	–	83,896
Net book value		₱95,217	₱15,361	₱3,756	₱1,494	₱746	₱1,297	₱2,029	₱13,974	₱133,874

As at June 30, 2018 and December 31, 2017, the net book values of customer-funded assets included in "Utility plant and others" account amounted to ₱3,104 million and ₱2,922 million, respectively. The corresponding liabilities to customers in the same amounts as at June 30, 2018 and December 31, 2017 are included in "Other noncurrent liabilities" account in the consolidated statements of financial position.

Construction in progress pertains to both electric capital projects ("*ECP*s") and non-*ECP*s. *ECP*s are capital projects involving construction of new electric distribution-related facilities and the upgrade and major rehabilitation of existing electrical facilities. Total interest capitalized amounted to ₱102 million and ₱78 million for the six months ended June 30, 2018 and 2017, respectively.

The average annual interest rates used for capitalization for the six months ended June 30, 2018 and 2017 ranged from 4.60% to 4.83% and 4.45% to 4.70%, respectively.

8. Investments in Associates and Interests in Joint Ventures

This account consists of the following as at June 30, 2018 and December 31, 2017:

	Place of Incorporation	Principal Activity	**2018**	2017
			Percentage of Ownership	
Associates				
RP Energy	Philippines	Power generation	**47**	47
FPM Power Holdings Limited ("*FPM Power*")	British Virgin Islands	Investment and holding company	**40**	40
Bauang Private Power Corporation ("*BPPC*")	Philippines	Power generation	**38**	38
Aclara Meters Philippines, Inc. ("*Aclara Meters*")	Philippines	Sale of metering products and services	**35**	35
Indra Philippines, Inc. ("*Indra Philippines*")	Philippines	Management and *IT* consultancy	**25**	25
GBPC	Philippines	Power generation	**14**	14
AF Payments	Philipines	Electronic payment clearing and settlement system operator	**10**	10
Joint Ventures				
SBPL	Philippines	Power generation	**51**	51
MRail-DESCO Joint Venture ("*MDJV*")	Philippines	Maintenance of mass transit system	**50**	50
Pure Meridian	Philippines	Renewable energy	**50**	50
St. Raphael	Philippines	Power generation	**50**	50
Mariveles Power	Philippines	Power generation	**49**	49
RSIC	Philippines	Insurance	**49**	49
Powersource First Bulacan Solar, Inc. ("*First Bulacan*")	Philippines	Renewable energy	**40**	40
Rockwell Business Center Joint Venture ("*RBC JV*")	Philippines	Real estate	**30**	30

The movements in investments in associates and interests in joint ventures account are as follows:

	June 30, 2018 (Unaudited) (Six months)	December 31, 2017 (Audited) (One year)
	(Amounts in millions)	
Acquisition costs:		
Balance at beginning of period	**₱14,477**	₱13,620
Additions	**292**	857
Balance at end of period	**14,769**	14,477

(Forward)

	June 30, 2018 (Unaudited) (Six months)	December 31, 2017 (Audited) (One year)
	(Amounts in millions)	
Accumulated equity in net losses:		
Balance at beginning of period	**(₱4,171)**	(₱3,748)
Equity in net earnings (losses)	**(146)**	221
Dividends	**(7)**	(473)
Impairment	**–**	(171)
Balance at end of period	**(4,324)**	(4,171)
Share in remeasurement adjustments on retirement liabilities:		
Balance at beginning of period	**(10)**	(12)
Actuarial gain (loss)	**(1)**	2
Balance at end of period	**(11)**	(10)
Share in cumulative translation adjustments:		
Balance at beginning of period	**1,150**	1,064
Translation adjustments	**359**	86
Balance at end of period	**1,509**	1,150
	₱11,943	₱11,446

The carrying values of investments in associates and interests in joint ventures follow:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
GBPC	**₱5,345**	₱5,197
FPM Power	**2,166**	1,863
RP Energy	**1,324**	1,373
RBC JV	**1,128**	1,066
Mariveles Power	**954**	954
Indra Philippines	**293**	278
SBPL	**124**	159
RSIC	**233**	236
Pure Meridian	**119**	117
First Bulacan	**82**	51
Aclara Meters	**71**	71
St. Raphael	**47**	48
MDJV	**16**	22
BPPC	**11**	11
AF Payments	**30**	–
	₱11,943	₱11,446

GBPC

On June 30, 2016, *MGen* and *JG Summit* executed a deed of absolute assignment of shares whereby *MGen* sold and assigned 153,921,676 shares representing 8% of its equity interest in *GBPC* to *JG Summit* for ₱3,151 million, resulting in reduction of *MGen*'s equity interest from 22% to 14%.

GBPC owns an aggregate of 854 *MW* (gross) of coal and diesel-fired power plants in operation in the Visayas which include Panay Energy Development Corporation's ("*PEDC*") 150 *MW CFB* coal-fired facility in Panay Island which started commercial operations in November 2016. A *PSA* for the 70 *MW* plant capacity has been provisionally approved by the *ERC* on January 17, 2017.

In June 2017, *GBPC* acquired a 50% equity interest in Alsons Thermal Energy Corporation ("*ATEC*"). *ATEC* holds 75% equity interest in a 105 *MW* (net) *CFB* plant in Maasim, Sarangani that started commercial operations in 2016. Another 105 *MW CFB* unit is targeted to be completed by 2019.

FPM Power

FPM Power is 40%-owned by *MERALCO* through *MPG Asia* (a subsidiary of *MGen)* and 60%-owned by First Pacific Company Limited ("*First Pacific*"). *FPM Power* has a 70% equity interest in *PacificLight Power*, which owns and operates a 2 x 400 *MW LNG*-fired power plant in Jurong Island, Singapore. *PacificLight Power*'s wholly owned subsidiary, PacificLight Energy Pte. Ltd., is engaged in energy trading.

RP Energy

On July 22, 2011, *MGen* signed a Shareholders' Agreement with Therma Power, Inc. ("*TPI*") and Taiwan Cogeneration International Corporation – Philippine Branch ("*TCIC*") for the construction and operation of a 2 x 300 *MW CFB*, coal-fired power plant to be located in the Subic Bay Freeport Zone. The development and operations shall be undertaken by *RP Energy,* the joint venture entity.

On February 3, 2015, *RP Energy* received the *SC*'s decision denying the Writ of Kalikasan case previously filed by certain opposing parties against its planned power plant due to insufficiency of evidence. The *SC* upheld the validity of the Environment Compliance Certificate ("*ECC*") and its first two (2) amendments, as well as the Lease and Development Agreement ("*LDA*") between *RP Energy* and Subic Bay Metropolitan Authority ("*SBMA*"). On February 23, 2016, the *LDA* and transmission line Right-of-Way ("*RoW*") lease agreement with *SBMA* were signed.

The development of the 2 x 300 *MW* project shall be implemented in two (2) phases. On October 13, 2016, the *EPC* for the first 300 *MW* was signed.

RP Energy's project has been issued a Certificate of Registration in June 2016 by the Board of Investments ("*BOI*") granting the project certain investment promotion incentives.

In April 2016, *RP Energy* signed separate *PSA*s with *MERALCO* and Aboitiz Energy Solutions, Inc. ("*Aboitiz Energy*"). *RP Energy* is awaiting the approval of its *PSA* with *MERALCO* by the *ERC*.

On December 22, 2016, *RP Energy* signed a loan agreement with three (3) local banks for the ₱31.5 billion project financing. The approval of the *PSA* between *RP Energy* and *Aboitiz Energy* by the *ERC* is a condition precedent to the first loan drawdown. As at July 30, 2018, the *PSA* was not yet approved by the *ERC* which restricted *RP Energy* to issue a notice to proceed to the *EPC* contractor and led to *RP Energy*'s inability to achieve financial close.

Site preparation of the first 300 *MW* unit has been completed, with expected commercial operations in the second half of 2021. The second phase shall follow within 12 months, subject to progress of *NGCP*'s *RoW* acquisition for the new transmission line that will connect the second phase to the grid.

RBC JV

RBC JV is a joint venture between Rockwell Land Corporation ("*Rockwell Land*") and *MERALCO* for a pre-agreed cooperation period, pursuant to which *Rockwell Land* built and managed three (3) Business Process Outsourcing-enabled buildings on a non-regulatory asset base property of *MERALCO*. Investment in *RBC JV* represents *MERALCO*'s 30% interest in the joint venture, while *Rockwell Land* has 70% interest in *RBC JV*.

Mariveles Power

On June 16, 2016, *MERALCO* and *Mariveles Power* executed a joint venture agreement to develop, construct, finance, own, operate and maintain a 4 x 132 *MW* coal-fired power plant and associated facilities in Mariveles, Bataan. The project is awaiting issuance of an *ECC* by the *DENR*.

Indra Philippines

Indra Philippines is an *IT* service provider in the country and in the Asia Pacific region, with a wide range of services across various industries. *Indra Philippines* provides services which meet certain of *MERALCO*'s *IT* requirements in the area of system development, outsourcing of Information Systems ("*IS*") and *IT* operations and management consulting.

RSIC

In accordance with the Agreement of Shareholders and Subscription of Shares among *MERALCO*, Pioneer Insurance and Surety Corporation ("*Pioneer Insurance*") and *RSIC*, *RSIC* issued common shares to *Pioneer Insurance* and *MERALCO*, resulting in a dilution of *MERALCO*'s ownership interest in *RSIC* to 49%. Under the Agreement, *MERALCO* has the right to sell to *Pioneer Insurance*, and *Pioneer Insurance* has the obligation to buy, *MERALCO*'s 49% stake in *RSIC* which is exercisable by *MERALCO* at any time during the period from January 1, 2023 to December 31, 2023.

AF Payments

MERALCO, through *Finserve*, has a 10% equity interest in *AF Payments*. *AF Payments* was incorporated in February 2014 primarily to operate and maintain an electronic payment clearing and settlement system through a contactless automated fare collection system for public utility, including generic contactless micropayment solution. It shall also supply and issue fare media and store value cards or reloadable cards for use in transport and non-transport facilities and operate and maintain the related hardware and software.

In 2017, due to the lower than expected penetration rate into the micropayments business, *MERALCO* recognized impairment charge of ₱171 million on the carrying amount of its investment in *AF Payments*. The recoverable amount of the investment in *AF Payments* was measured using the estimate of the value in use of the investment. The valuation analysis involved discounting estimates of free cash flows by the discount rate of 11.9%. The cash flows were based on the most recent financial budgets and forecasts representing best estimate of ranges of economic conditions that will exist over the forecast period. The forecast period covers the remaining concession term.

SBPL

On August 29, 2013, *MGen* signed a Joint Development Agreement with New Growth B.V., a 100% subsidiary of Electricity Generating Public Company Limited of Thailand ("*EGCO*") for the development of a new 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon. *MGen*'s equity in the joint venture company, *SBPL*, is 51%, with the option to assign or transfer 2% thereof to a separate entity. On November 11, 2014, the *DENR* granted *SBPL* an *ECC* covering the 455 *MW* (net) supercritical coal-fired power plant.

SBPL's *EPC* was executed with the Consortium of Daelim Industrial Co. Ltd. and Mitsubishi Corporation following a competitive selection process ("*CSP*") on October 8, 2014. The construction period is set at 42 months from the commencement date of December 8, 2015.

On May 29, 2014, *MERALCO* signed a long-term *PSA* with *SBPL*. The *PSA* was approved by the *ERC* in May 2015.

On October 8, 2015, *SBPL* entered into an Omnibus Agreement and related agreements with certain financial institutions providing for a term loan facility in an amount of up to ₱42.15 billion for the financing of the project. The initial drawdown was made on December 1, 2015. On December 11, 2015, *SBPL* entered into an Operation and Maintenance Agreement with Pearl Energy Philippines Operating, Inc., a wholly owned subsidiary of *QPPL*, for the operations and maintenance of the power plant.

The expected commercial operations of *SBPL* is third quarter of 2019.

Pure Meridian

On January 7, 2016, *MERALCO* and Repower Energy Development Corporation ("*REDC*") entered into a joint venture through, *Pure Meridian*, which shall undertake the development of various mini-hydroelectric power projects.

Aclara Meters

Aclara Meters was established in 1979 together with General Electric Company of U.S.A., to serve the Philippine market for American National Standard Institute ("*ANSI*")-type Watt-hour meters. In August 2017, Aclara Technologies LLC ("*Aclara LLC*"), an affiliate of Sun Capital Partners Inc., acquired General Electric Company of U.S.A.'s 65% equity in *Aclara Meters*. In December 2017, Hubbel Incorporated, an international manufacturer of electrical and electronic products, entered into a definitive agreement to acquire *Aclara LLC*.

St. Raphael

On April 27, 2016, *MGen* and Semirara Mining and Power Corporation entered a joint venture agreement to develop a 2 x 350 *MW* sub-critical pulverized coal-fired power plant in Calaca, Batangas. The development and operations shall be undertaken by *St. Raphael*, the joint venture entity. A *PSA* was signed by *St. Raphael* and *MERALCO* in April 2016 for the 400 *MW* of the plant's capacity. The *PSA* is pending approval by the *ERC*. Development activities for the project are ongoing and target commercial operations of the power plant is in 2021.

First Bulacan

On January 23, 2017, *Spectrum* entered into a shareholders' agreement with Sunseap International Pte Ltd. and Powersource Philippines Development Corporation for the development of solar energy projects. The development and operations of the projects will be undertaken by *First Bulacan*.

MDJV

On June 2, 2014, *MRail* and *DESCO* entered into a Joint Venture Agreement for the general overhaul and rehabilitation of three (3) units of diesel electric locomotives by the Philippine National Railways ("*PNR*"). Two (2) units were completed and turned over on January 10, 2017 and one (1) unit on April 19, 2017. The Joint Venture Agreement is on its two-year warranty period that will end in April 2019.

BPPC

BPPC was incorporated and registered with the *SEC* on February 3, 1993 to engage in the power generation business.

In accordance with the Build-Operate-Transfer ("*BOT*") Agreement signed in 1993, First Private Power Corporation ("*FPPC*"), then parent company, constructed the 215 *MW* Bauang Power Plant ("*Bauang Plant*"), and operated the same under a 15-year Cooperation Period up to July 25, 2010.

The *Bauang Plant* has since been turned over to the *NPC* without any compensation and free of any liens. In 2010, the *SEC* approved the merger of *FPPC* and *BPPC*, with *BPPC* as the surviving entity. *BPPC* management continues to evaluate its investment options in power generation and allied industries.

On November 24, 2017, *BPPC*'s *BOD* and stockholders approved a resolution to amend its articles of incorporation shortening the term of its existence from "fifty (50) years from the date of incorporation hereof" to "until June 30, 2019". As at July 30, 2018, *BPPC* is still in the process of obtaining the related necessary regulatory approvals.

The condensed statements of financial position of material associates follow:

	June 30, 2018 (Unaudited)		
	GBPC	***FPM Power***	***RP Energy***
	(Amounts in millions)		
Current assets	**₱23,377**	**₱8,674**	**₱497**
Noncurrent assets	**58,489**	**48,451**	**2,237**
Current liabilities	**(8,892)**	**(24,656)**	**(19)**
Noncurrent liabilities	**(37,019)**	**(28,060)**	**(5)**
Non-controlling interests	**(5,570)**	**1,006**	**–**
Net assets	**₱30,385**	**₱5,415**	**₱2,710**

	December 31, 2017 (Audited)		
	GBPC	*FPM Power*	*RP Energy*
	(Amounts in millions)		
Current assets	₱26,002	₱6,821	₱758
Noncurrent assets	58,063	45,718	2,073
Current liabilities	(11,661)	(20,361)	(10)
Noncurrent liabilities	(38,043)	(28,519)	(6)
Non-controlling interests	(5,033)	999	–
Net assets	₱29,328	₱4,658	₱2,815

The condensed statements of comprehensive income of material associates are as follows:

	For the Six Months Ended June 30 (Unaudited)					
	2018			2017		
	GBPC	***FPM Power***	***RP Energy***	*GBPC*	*FPM Power*	*RP Energy*
	(Amounts in millions)					
Revenues	**₱13,288**	**₱18,070**	**₱6**	₱4,760	₱6,405	₱2
Costs and expenses	**(11,676)**	**(19,200)**	**(111)**	(4,193)	(6,383)	(21)
Net income (loss)	**1,612**	**(1,130)**	**(105)**	567	22	(19)
Non-controlling interests	**(553)**	**415**	**–**	(222)	159	–
Net income (loss) attributable to equity holders of the parent	**1,059**	**(715)**	**(105)**	345	181	(19)
Other comprehensive income	**–**	**899**	**–**	–	24	–
Total comprehensive income (loss)	**₱1,059**	**₱184**	**(₱105)**	₱345	₱205	(₱19)
Dividends received	**₱–**	**₱–**	**₱–**	₱–	₱–	₱–

The reconciliation of the net assets of the foregoing material associates to the carrying amounts of investments in these associates recognized in the consolidated statements of financial position is as follows:

	June 30, 2018 (Unaudited)		
	GBPC	***FPM Power***	***RP Energy***
	(Amounts in millions, except % of ownership)		
Net assets of associates	**₱30,385**	**₱5,415**	**₱2,710**
Proportionate ownership in associates (%)	**14**	**40**	**47**
	4,254	**2,166**	**1,274**
Goodwill	**1,091**	**–**	**50**
	₱5,345	**₱2,166**	**₱1,324**

	December 31, 2017 (Audited)		
	GBPC	*FPM Power*	*RP Energy*
	(Amounts in millions, except % of ownership)		
Net assets of associates	₱29,328	₱4,658	₱2,815
Proportionate ownership in associates (%)	14	40	47
	4,106	1,863	1,323
Goodwill	1,091	–	50
	₱5,197	₱1,863	₱1,373

The following is the aggregate information of associates that are considered as not individually material:

	For the Six Months Ended June 30 (Unaudited)	
	2018	2017
	(Amounts in millions)	
Share in net income (loss)	**₱23**	(₱12)
Share in other comprehensive income (loss)	**(1)**	2
Share in total comprehensive income (loss)	**₱22**	(₱10)
Dividends received	**₱7**	₱10

Joint Ventures

The condensed statements of financial position of material joint ventures follow:

	June 30, 2018 (Unaudited)		
	RBC JV	***SBPL***	***Mariveles Power***
	(Amounts in millions)		
Current assets	**₱1,091**	**₱556**	**₱18**
Noncurrent assets	**3,061**	**38,567**	**1,952**
Current liabilities	**(391)**	**(266)**	**(23)**
Noncurrent liabilities	**–**	**(38,614)**	**–**
Net assets	**₱3,761**	**₱243**	**₱1,947**

	December 31, 2017(Audited)		
	RBC JV	*SBPL*	*Mariveles Power*
	(Amounts in millions)		
Current assets	₱837	₱433	₱17
Noncurrent assets	3,144	29,313	1,952
Current liabilities	(427)	(331)	(22)
Noncurrent liabilities	–	(29,103)	–
Net assets	₱3,554	₱312	₱1,947

The foregoing condensed statements of financial position include the following:

	June 30, 2018 (Unaudited)		
	RBC JV	***SBPL***	***Mariveles Power***
	(Amounts in millions)		
Cash and cash equivalents	**₱892**	**₱281**	**₱18**
Current financial liabilities (excluding trade payables)	**(45)**	**(256)**	**(22)**

	December 31, 2017 (Audited)		
	RBC JV	*SBPL*	*Mariveles Power*
	(Amounts in millions)		
Cash and cash equivalents	₱653	₱339	₱17
Current financial liabilities (excluding trade payables)	(26)	(302)	–

The condensed statements of comprehensive income of material joint ventures are as follows:

	For the Six Months Ended June 30 (Unaudited)					
	2018			2017		
	RBC JV	***SBPL***	***Mariveles Power***	*RBC JV*	*SBPL*	*Mariveles Power*
	(Amounts in millions)					
Revenues	**₱348**	**₱–**	**₱–**	₱348	₱109	₱–
Costs and expenses	**(180)**	**(72)**	**–**	(105)	(50)	(10)
Other income - net	**80**	**5**	**1**	–	–	–
Provision for income tax - net	**(42)**	**–**	**–**	(57)	(20)	–
Net income (loss)	**₱206**	**(₱67)**	**₱1**	₱186	₱39	(₱10)
Dividends received	**₱–**	**₱–**	**₱–**	₱36	₱–	₱–

The foregoing condensed statements of comprehensive income include the following:

	For the Six Months Ended June 30 (Unaudited)					
	2018			2017		
	RBC JV	***SBPL***	***Mariveles Power***	*RBC JV*	*SBPL*	*Mariveles Power*
	(Amounts in millions)					
Depreciation	**₱103**	**₱1**	**₱–**	₱103	₱2	₱–
Interest income	**(4)**	**(1)**	**–**	(4)	–	–
Provision for income tax - net	**42**	**–**	**–**	57	20	–

The reconciliation of the net assets of the foregoing material joint ventures to the carrying amounts of investments in these joint ventures recognized in the consolidated statements of financial position is as follows:

	June 30, 2018 (Unaudited)		
	RBC JV	***SBPL***	***Mariveles Power***
	(Amounts in millions, except % of ownership)		
Net assets of joint ventures	**₱3,761**	**₱243**	**₱1,947**
Proportionate ownership in joint ventures (%)	**30**	**51**	**49**
	₱1,128	**₱124**	**₱954**

	December 31, 2017 (Audited)		
	RBC JV	*SBPL*	*Mariveles Power*
	(Amounts in millions, except % of ownership)		
Net assets of joint ventures	₱3,554	₱312	₱1,947
Proportionate ownership in joint ventures (%)	30	51	49
	₱1,066	₱159	₱954

The following is the condensed financial information of joint ventures which are considered as not material:

	For the Six Months Ended June 30 (Unaudited)	
	2018	2017
	(Amounts in millions)	
Share in net loss	**(₱10)**	(₱14)
Share in other comprehensive loss	**–**	–
Share in total comprehensive loss	**(₱10)**	(₱14)
Dividends received	**₱–**	₱–

9. Investment Properties

The movements in investment properties are as follows:

	June 30, 2018 (Unaudited)		
	Land	**Buildings and Improvements**	**Total**
	(Amounts in millions)		
Cost	**₱1,427**	**₱204**	**₱1,631**
Less accumulated depreciation:			
Balance at January 1, 2018	**–**	**122**	**122**
Depreciation	**–**	**3**	**3**
Balance at June 30, 2018	**–**	**125**	**125**
	₱1,427	**₱79**	**₱1,506**

	December 31, 2017 (Audited)		
	Land	Buildings and Improvements	Total
	(Amounts in millions)		
Cost	₱1,427	₱204	₱1,631
Less accumulated depreciation:			
Balance at January 1, 2017	–	118	118
Depreciation	–	4	4
Balance at December 31, 2017	–	122	122
	₱1,427	₱82	₱1,509

Investment properties consist of real properties held for capital appreciation, former substation sites and other non-regulatory asset base real properties. Some of these investment properties are being leased out.

The aggregate fair values of the investment properties as at June 30, 2018 and December 31, 2017 are as follows:

	Amount
	(in millions)
Land	₱1,863
Buildings and improvements	150

Land pertains primarily to properties where the *BPO* buildings and "Strip" mall are located and to other non-regulated asset base properties.

The fair values of investment properties were determined by independent, professionally qualified appraisers. The fair value represents the price that would be received to sell an investment property in an orderly transaction between market participants at the measurement date.

The fair value disclosures of the investment properties are categorized as Level 3 as there is no active market for identical or similar properties. The inputs include price per square meter ranging from ₱40 to ₱96,000. There have been no changes in the valuation techniques used.

In conducting the appraisal, the independent professional appraisers used one (1) of the following approaches:

a. Market Data or Comparative Approach

   Under this approach, the value of the property is based on sales and listings of comparable property registered within the vicinity. This approach requires the establishment of a comparable property by reducing comparative sales and listings to a common denominator with the subject property. This is done by adjusting the differences between the subject property and those actual sales and listings regarded as comparables. The properties used are either situated within the immediate vicinity or at different floor levels of the same building, whichever is most appropriate to the property being valued. Comparison was premised on the following: location, size and physical attributes, selling terms, facilities offered and time element.

b. Depreciated Replacement Cost Approach

   This method of valuation considers the cost to reproduce or replace in new condition the assets appraised in accordance with current market prices for similar assets, with allowance for accrued depreciation based on physical wear and tear and obsolescence.

10. Other Noncurrent Assets

This account consists of:

	Note	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
		(Amounts in millions)	
Financial assets:			
HTM investments	*14 and 26*	**₱30,959**	₱27,180
AFS financial assets	*26*	**3,970**	4,360
Advance payments to a supplier and others	*26 and 29*	**3,506**	3,563
Nonfinancial assets:			
Net under-recoveries of pass-through charges	*2*	**7,331**	1,654
Intangible assets	*7*	**2,095**	2,254
Deferred input *VAT*		**1,093**	1,565
Receivable from *BIR*	*28*	**181**	181
Goodwill		**35**	35
Others		**1,344**	1,156
		₱50,514	₱41,948

HTM Investments

The details of *HTM* investments are as follows:

	June 30, 2018 (Unaudited)			December 31, 2017 (Audited)		
	Current Portion (see *Note 14*)	**Noncurrent Portion**	**Total**	Current Portion (see *Note 14*)	Noncurrent Portion	Total
			(Amounts in millions)			
Government securities	**₱2,148**	**₱30,021**	**₱32,169**	₱9,001	₱26,245	₱35,246
Private debt securities	**–**	**938**	**938**	–	935	935
	₱2,148	**₱30,959**	**₱33,107**	₱9,001	₱27,180	₱36,181

This account represents investments in government securities issued by the Republic of Philippines and private debt securities issued by Philippine listed corporations.

AFS Financial Assets

The details of *AFS* financial assets are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Investments in government securities	**₱3,019**	₱3,233
Investments in corporate bonds	**655**	679
Investments in *UITF*s	**1**	203
Investments in shares of stock and club shares:		
Quoted	**251**	204
Unquoted	**44**	41
	₱3,970	₱4,360

The rollforward of unrealized gains (losses) on quoted *AFS* financial assets, net of tax, included in the consolidated statements of financial position follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Balance at beginning of period	**(₱160)**	(₱271)
Unrealized gains (losses) on change in fair value	**(176)**	111
Balance at end of period	**(₱336)**	(₱160)

Intangible Assets

The movements of intangible assets are as follows:

	June 30, 2018 (Unaudited)			
	Software	**Franchise**	**Land and Leasehold Rights**	**Total**
	(Amounts in millions)			
Cost:				
Balance at January 1, 2018	**₱4,873**	**₱49**	**₱431**	**₱5,353**
Additions	**120**	**–**	**–**	**120**
Retirement	**(4)**	**–**	**–**	**(4)**
Balance at June 30, 2018	**4,989**	**49**	**431**	**5,469**
Less accumulated amortization:				
Balance at January 1, 2018	**2,823**	**–**	**276**	**3,099**
Amortization	**271**	**–**	**8**	**279**
Retirement	**(4)**	**–**	**–**	**(4)**
Balance at June 30, 2018	**3,090**	**–**	**284**	**3,374**
	₱1,899	**₱49**	**₱147**	**₱2,095**

		December 31, 2017 (Audited)			
	Note	Software	Franchise	Land and Leasehold Rights	Total
			(Amounts in millions)		
Cost:					
Balance at January 1, 2017		₱4,755	₱49	₱431	₱5,235
Additions		158	–	–	158
Disposals/retirement		(10)	–	–	(10)
Reclassifications	*7*	(30)	–	–	(30)
Balance at December 31, 2017		4,873	49	431	5,353
Less accumulated amortization:					
Balance at January 1, 2017		2,264	–	258	2,522
Amortization		569	–	18	587
Disposals/retirement		(10)	–	–	(10)
Balance at December 31, 2017		2,823	–	276	3,099
		₱2,050	₱49	₱155	₱2,254

Deferred Input VAT

The amount includes portion of input *VAT* incurred and paid in connection with purchase of capital assets in excess of ₱1 million per month. As provided for under *RA* No. 9337 ("*EVAT Law*"), said portion of input *VAT* shall be deferred and credited evenly over the estimated useful lives of the related capital assets or 60 months, whichever is shorter, against the output *VAT* due.

Net Under-Recoveries of Pass-through Charges

This account represents generation and other pass-through costs incurred by *MERALCO* and *CEDC* as *DU*s and which are still to be billed, covered by the approved recovery mechanism of the *ERC*. The balance also includes other net under-recoveries of generation and other pass-through charges of current and prior periods, which are the subject of various applications for recovery and approval by the *ERC*.

Provision for impairment loss on net under-recoveries of pass-through charges amounted to ₱4,436 million as at June 30, 2018 and December 31, 2017.

See *Note 12 - Trade and Other Receivables*.

11. Cash and Cash Equivalents

This account consists of:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Cash on hand and in banks	**₱9,093**	₱6,178
Cash equivalents	**41,685**	39,759
	₱50,778	₱45,937

Cash in banks earns interest at prevailing bank deposit rates. Cash equivalents are temporary cash investments, which are made for varying periods up of to three (3) months depending on *MERALCO Group*'s immediate cash requirements, and earn interest at the prevailing short-term investment rates.

12. Trade and Other Receivables

This account consists of:

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Trade:			
Electricity	*22 and 26*	**₱23,639**	₱23,505
Service contracts		**3,355**	4,196
Cost and estimated earnings in excess of billings on uncompleted contracts		**958**	759
Nontrade	*22 and 26*	**1,555**	1,366
		29,507	29,826
Less allowance for doubtful accounts		**1,837**	3,538
		₱27,670	₱26,288

Movements in allowance for doubtful accounts for trade and other receivables are as follows:

	June 30, 2018 (Unaudited)			
	Balance at January 1, 2018	**Provisions (Reversals)**	**Write-offs**	**Balance at June 30, 2018**
		(Amounts in millions)		
Trade - electricity	**₱3,307**	**(₱1,614)**	**(₱94)**	**₱1,599**
Other trade receivables	**229**	**7**	**–**	**236**
Nontrade receivables	**2**	**–**	**–**	**2**
	₱3,538	**(₱1,607)**	**(₱94)**	**₱1,837**

	December 31, 2017 (Audited)			
	Balance at January 1, 2017	Provisions (Reversals)	Write-offs	Balance at December 31, 2017
		(Amounts in millions)		
Trade - electricity	₱2,991	₱651	(₱335)	₱3,307
Other trade receivables	219	12	(2)	229
Nontrade receivables	4	(2)	–	2
	₱3,214	₱661	(₱337)	₱3,538

	June 30, 2018 (Unaudited)				December 31, 2017 (Audited)			
	Trade - Electricity	**Other Trade Receivables**	**Nontrade Receivables**	**Total**	Trade - Electricity	Other Trade Receivables	Nontrade Receivables	Total
				(Amounts in millions)				
Individually impaired	**₱488**	**₱236**	**₱2**	**₱726**	₱2,708	₱229	₱2	₱2,939
Collectively impaired	**1,111**	**–**	**–**	**1,111**	599	–	–	599
	₱1,599	**₱236**	**₱2**	**₱1,837**	₱3,307	₱229	₱2	₱3,538

Trade Receivables – Electricity

Trade receivables of *MERALCO* and *CEDC* include charges for pass-through costs. Pass-through costs of *MERALCO* consist of generation, transmission and *SL* charges, which represent 56%, 10% and 4%, respectively, of the total billed amount in 2018 and 55%, 10% and 4%, respectively, of the total billed amount in 2017. Billed receivables are due 10 days after bill date. *MERALCO*'s and *CEDC*'s trade receivables are noninterest-bearing and are substantially secured by bill deposits. Electricity consumed after the meter reading cut-off dates, which will be billed to customers in the immediately following billing period, is included as part of trade receivables.

See *Note 26 – Financial Assets and Financial Liabilities.*

Trade Receivables – Service Contracts

Service contracts receivable arise from contracts entered into by the *MIESCOR Group*, *e-MVI Group*, *CIS Group*, *MRail*, *MServ*, *Comstech* and *Spectrum* for construction, engineering, related manpower, consulting, light rail maintenance, data transport, bills collection, tellering and e-business development, energy management services, energy systems management and harnessing renewable energy to third parties.

Receivables from service contracts and others are noninterest-bearing and are generally on 30- to 90-day terms.

See *Note 10 - Other Noncurrent Assets*.

13. Inventories

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Materials and supplies:		
At cost	**₱3,646**	₱3,529
At net realizable value ("*NRV*")	**3,447**	3,330
Materials and supplies at *NRV*	**₱3,447**	₱3,330

14. Other Current Assets

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Financial assets:			
Short-term investments		**₱8,592**	₱2,532
Advances to an associate	*22 and 26*	**6,000**	5,703
HTM investments	*10 and 26*	**2,148**	9,001
Current portion of advance payments to a supplier		**190**	178
Nonfinancial assets:			
Prepayments		**2,502**	2,507
Prepaid tax		**1,268**	1,287
Input *VAT*		**1,261**	665
Pass-through *VAT* - net		**470**	846
Others		**201**	158
		₱22,632	₱22,877

Pass-through *VAT* pertains to *VAT* on generation and transmission costs billed to the *DU*, which are in turn billed to the customers. Remittance of such pass-through *VAT* to the generation companies is based on collection of billed receivables from the customers.

Short-term investments are temporary cash placements which are made for varying years beyond three (3) months but not exceeding 12 months, and earn interest at the prevailing short-term placement investment rates.

15. Equity

Common Stock

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(In millions, except par value)	
Authorized - ₱10 par value a share	**1,250**	1,250
Issued and outstanding - number of shares	**1,127**	1,127

There was no movement in the number of shares of *MERALCO*'s common stock.

The common shares of *MERALCO* were listed in the *PSE* on January 8, 1992. There are 43,036 and 43,449 shareholders of *MERALCO*'s common shares as at June 30, 2018 and December 31, 2017, respectively.

Unappropriated Retained Earnings

The unappropriated retained earnings include accumulated earnings of subsidiaries, associates and joint ventures, and the balance of *MERALCO*'s revaluation increment in utility plant and others and investment properties carried at deemed cost and deferred tax assets and unrealized foreign exchange gains totaling to ₱45,678 million and ₱43,831 million as at June 30, 2018 and December 31, 2017, respectively. These amounts are restricted for dividend declaration purposes as of the close of the respective reporting period

The following are the cash dividends declared on common shares in the second quarter of 2018 and 2017:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
February 26, 2018	March 28, 2018	April 25, 2018	₱8.07	₱9,090
February 27, 2017	March 27, 2017	April 21, 2017	9.30	10,482

The *BOD*-approved dividend policy of *MERALCO* consists of (i) regular cash dividends equivalent to 50% of *CCNI* for the year, and (ii) special dividend determined on a "look-back" basis. Declaration and payment of special dividend are dependent on the availability of unrestricted retained earnings and availability of free cash. The declaration, record and payment dates shall be consistent with the guidelines and regulations of the Philippine *SEC*.

Treasury Shares

Treasury shares represent 172,412 subscribed shares and the related rights of employees who have opted to withdraw from the *ESPP* in accordance with the provisions of the *ESPP* and which *MERALCO* purchased.

16. Interest-bearing Long-term Financial Liabilities

This account consists of the following:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Long-term portion of interest-bearing financial liabilities – long-term debt	**₱24,410**	₱24,786
Current portion of interest-bearing financial liabilities:		
Long-term debt	**345**	388
Redeemable preferred stock	**1,493**	1,496
	1,838	1,884
	₱26,248	₱26,670

All of the redeemable preferred shares have been called as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. The accrued interests amounted to ₱250 million as at June 30, 2018 and December 31, 2017. Interest is no longer accrued when the preferred shares are called for redemption.

The details of interest-bearing long-term financial liabilities are as follows:

Description	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
	(Amounts in millions)	
Fixed Rate Loans		
₱11.5 Billion 7-year Bonds	**₱11,500**	₱11,500
₱7.0 Billion 12-year Bonds	**7,000**	7,000
₱7.2 Billion Note Facility Agreement	**5,760**	6,120
₱600 Million Term Loan Facilities	**540**	600
₱130 Million Term Loan Facility	**70**	82
Total long-term debt	**24,870**	25,302
Less unamortized debt issuance costs	**115**	128
	24,755	25,174
Redeemable Preferred Stock	**1,493**	1,496
	26,248	26,670
Less current portion	**1,838**	1,884
Long-term portion of interest-bearing financial liabilities	**₱24,410**	₱24,786

All of *MERALCO*'s interest-bearing long-term financial liabilities as at June 30, 2018 and December 31, 2017 are denominated in Philippine peso. The scheduled maturities of *MERALCO*'s outstanding long-term debt at nominal values as at June 30, 2018 are as follows:

	Amount
	(In millions)
Less than one (1) year	₱384
One (1) year up to two (2) years	413
More than two (2) years up to three (3) years	11,913
More than three (3) years up to four (4) years	390
More than four (4) years up to five (5) years	390
More than five (5) years	11,380
	₱24,870

₱18.5 Billion Fixed Rate Puttable Bonds

On September 23, 2013, the *BOD* of *MERALCO* authorized the offer, sale and issuance by way of public offering in the Philippines, 7- and 12-year corporate bonds, puttable in five (5) and 10 years, respectively, with an aggregate principal amount of up to ₱15 billion and with an overallotment option of up to ₱5.0 billion. The 12-year corporate bonds also include a call option, whereby *MERALCO* may redeem (in whole but not in part only) the outstanding bonds on the 7th year from issue date at the early redemption price of 101.0%. The put and call options are clearly and closely related to the host instruments, and thus, were not recognized separately.

On December 12, 2013, the ₱11.5 billion fixed rate puttable bonds due in 2020 and ₱7.0 billion fixed rate puttable bonds due in 2025, were listed on the Philippine Dealing and Exchange Corporation.

The net proceeds of the bonds were utilized for refinancing certain loans including principal payments, accrued interest, prepayment penalties and other financing costs.

₱7.2 Billion Note Facility Agreement

In February 2014, *MERALCO* entered into a ₱7,200 million, 10-year Fixed Rate Note Facility Agreement due in February 2024. The principal is payable in nominal annual amortizations with a balloon payment upon final maturity.

₱600 Million Term Loan Facilities

In 2017, *MServ* obtained a total of ₱600 million, 10-year fixed rate term loans. The principal amount is payable over 10 years until January 2027.

₱130 Million Term Loan Facility

On June 27, 2014, *MIESCOR* obtained a ₱130 million, 7-year fixed rate term loan. The principal is payable over six (6) years until June 2021.

The annual interest rates for the interest-bearing financial liabilities are 4.38% to 5.50% as at June 30, 2018 and December 31, 2017.

Debt Covenants

MERALCO's loan agreements require compliance with debt service coverage of 1.1 times calculated on specific measurement dates. The agreements also contain restrictions with respect to the creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

As at June 30, 2018 and December 31, 2017, *MERALCO* is in compliance with all of the covenants of the loan agreements.

Unamortized Debt Issuance Costs

The following presents the changes to the unamortized debt issuance costs:

	Note	**June 30, 2018 (Unaudited) (Six Months)**	December 31, 2017 (Audited) (One Year)
		(Amounts in millions)	
Balance at beginning of period		**₱128**	₱153
Amortization charged to interest and other financial charges	*24*	**(13)**	(25)
Balance at end of period		**₱115**	₱128

Redeemable Preferred Stock

The movements in the number of shares of the redeemable preferred stock, which have all been called, are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
Balance at beginning of period	**149,615,014**	150,157,797
Redemptions	**(320,427)**	(542,783)
Balance at end of period	**149,294,587**	149,615,014

The original "Terms and Conditions" of *MERALCO*'s Special Stock Subscription Agreement, which required an applicant to subscribe to preferred stock with 10% dividend to cover the cost of extension of, or new, distribution facilities, have been amended by the *Magna Carta* and the *DSOAR,* effective June 17, 2004 and January 18, 2006, respectively. The amendment sets forth the guidelines for the issuance of preferred stock, only if such instrument is available.

17. Customers' Deposits

This account consists of:

	June 30, 2018 (Unaudited)			December 31, 2017 (Audited)		
	Current Portion (see *Note 21*)	**Noncurrent Portion**	**Total**	Current Portion (see *Note 21*)	Noncurrent Portion	Total
			(Amounts in millions)			
Bill deposits	**₱2,330**	**₱25,165**	**₱27,495**	₱2,555	₱24,000	₱26,555
Meter deposits	**311**	**–**	**311**	424	–	424
	₱2,641	**₱25,165**	**₱27,806**	₱2,979	₱24,000	₱26,979

Bill Deposits

Bill deposits serve to guarantee payment of bills by a customer.

As provided in the *Magna Carta* and *DSOAR*, all captive customers are required to pay a deposit to the *DU,* equivalent to the estimated monthly bill calculated based on applied load, which shall be recognized as bill deposit of the captive customer. Such deposit shall be updated annually based on the historical 12-month average bill. A captive customer who has paid his electric bills on or before due date for three (3) consecutive years may apply for the full refund of the bill deposit, together with the accrued interests, prior to the termination of his service; otherwise bill deposits and accrued interests shall be refunded within one (1) month from the termination of service, provided all bills have been paid.

On February 22, 2010, the amended *DSOAR,* which became effective on April 1, 2010, was promulgated by the *ERC*. Under the amended *DSOAR,* interest on bill deposits for both residential and non-residential customers shall be computed using the equivalent peso savings account interest rate of the Land Bank of the Philippines ("*Land Bank*") or other government banks, on the first working day of the year, subject to the confirmation of the *ERC*.

As provided for under *ERC* Resolution No. 1, *A Resolution Adopting the Revised Rules for the Issuance of Licenses to Retail Electricity Suppliers*, a local *RES* may require security deposits from its

contestable customers, which shall earn interest equivalent to the actual interest earnings of the total amount of deposits received from the customers.

The following are the movements of the bill deposits account:

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Balance at beginning of period		**₱26,555**	₱26,095
Additions		**2,395**	4,477
Refunds		**(1,455)**	(4,017)
Balance at end of period		**27,495**	26,555
Less portion maturing within one year	*21*	**2,330**	2,555
Noncurrent portion of bill deposits and related interests		**₱25,165**	₱24,000

Meter Deposits

Meter deposits were intended to guarantee the cost of meters installed.

The *Magna Carta* for residential customers (effective July 19, 2004) and *DSOAR* (effective February 2, 2006) for non-residential customers exempt all customer groups from payment of meter deposits beginning July 2004 for residential customers and April 2006 for non-residential customers.

The *ERC* released Resolution No. 8, Series of 2008, otherwise known as "Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers" ("*Rules*") which required the refund of meter deposits from the effectivity of said *Rules* on July 5, 2008. Under the *Rules*, a customer has the option of receiving his refund in cash, check, credit to future monthly billings, or as an offset to other due and demandable claims of the *DU* against him.

The total amount of refund shall be equivalent to the meter deposit paid by the customer plus the total accrued interest earned from the time the customer paid the meter deposit until the day prior to the start of refund.

On August 8, 2008, in compliance with the *Rules*, *MERALCO* submitted to the *ERC* an accounting of the total meter deposit principal amount for refund. The actual refund of meter deposits commenced on November 3, 2008.

In May 2014, *MERALCO* implemented automatic crediting or offsetting of the remaining unclaimed meter deposit refund ("*MDR*") as approved by *ERC*, including all accrued interests to the corresponding existing and active service contracts. This was done after releasing a "Final Notice" to advice our customers, particularly those who have not yet claimed their *MDR*, to claim the same prior to *MERALCO*'s implementation of auto-crediting. Thus, all remaining unclaimed *MDR* as reported to the *ERC* as at December 31, 2014 are only for terminated services.

In May 2016, the *ERC* promulgated *ERC* Resolution No. 12, Series of 2016 entitled, "Amended Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Consumers," directing all *DU*s to deposit all unclaimed meter deposits including all accrued interests in a government or commercial bank under a single savings account and in the name of the *DU* strictly intended for the claimants of meter deposits. Further, customers were given until December 31, 2017 within which to claim their *MDR*, to be facilitated by the *DU*; otherwise, all unclaimed meter deposits, including accrued interest will be subject to an escheat proceeding in favor of the government.

In compliance with said *ERC* directive, in July 2016, *MERALCO* deposited unclaimed meter deposits in a single savings account. In May 2017, *MERALCO* submitted its duly Audited Report to the *ERC* in compliance with the *ERC*'s directive to all *DU*s to submit an Audit Report on their *MDR* implementation, pursuant to *ERC* Resolution No. 13, Series of 2016, entitled, "Guidelines to Govern the Audit Process of Meter Deposit Refund to Residential and Non-Residential Customers."

Finally, in April 2018, *MERALCO* submitted to the *ERC* the total amount of unclaimed *MDR* that will be subject of an escheat proceeding. *MERALCO* is just waiting for instructions from the *OSG* and/or *ERC* on the next steps with respect to said escheat proceedings in favor of the government.

18. Provisions

Provisions consist of amounts recognized for probable losses and expenses relating to claims against the *MERALCO Group*, among others. The movements follow:

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Balance at beginning of period		**₱34,111**	₱38,224
Reversals for the period - net		**(429)**	(2,539)
Settlements		**(115)**	(1,574)
Balance at end of period		**33,567**	34,111
Less current portion	*21*	**15,413**	15,655
Noncurrent portion of provisions		**₱18,154**	₱18,456

The balance of provisions substantially represents the amounts of claims related to a commercial contract which remains unresolved and local taxes being contested as discussed in *Note 28 – Contingencies and Legal Proceedings*, consistent with the limited disclosure as allowed in *PFRS*.

19. Customers' Refund

This account represents the balance of the refund related to the *SC* decision promulgated on April 30, 2003, which is continuously being refunded based on documents presented by claimants.

In June 2003, the *ERC,* in the implementation of the *SC* decision, ordered *MERALCO* to refund to its customers an equivalent ₱0.17 per *kWh* for billings made from February 1994 to April 2003.

On February 1, 2011, *MERALCO* filed a motion with the *ERC* to: (i) allow it to continue with the implementation of the refund to eligible accounts or customers under Phases I to IV, for another five (5) years from the end of Phase IV-B, or from the end of December 2010 to the end of December 2015; and (ii) adopt its proposed procedures for the implementation of the *SC* refund during the extended period. The *ERC* approved *MERALCO*'s motion in its Order dated February 7, 2011.

On December 18, 2015, *MERALCO* filed a Motion seeking the *ERC's* approval to continue refunding to eligible accounts or customers under Phases I to IV, for three (3) years from January 1, 2016 or until December 31, 2018.

20. Notes Payable

Notes payable represent unsecured interest-bearing working capital loans obtained from local banks. Annual interest rates range from 2.75% to 4.75% and 2.8% to 4.25% as at June 30, 2018 and December 31, 2017, respectively.

Interest expense on notes payable amounted to ₱238 million and ₱153 million for the six months ended June 30, 2018 and 2017, respectively.

See *Note 24 – Expenses and Income*.

21. Trade Payables and Other Current Liabilities

This account consists of the following:

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Trade accounts payable	*22 and 23*	**₱40,044**	₱32,574
Provisions	*18 and 28*	**15,413**	15,655
Output *VAT* - net		**8,936**	8,019
Accrued expenses:			
Employee benefits		**1,651**	2,032
Taxes		**1,419**	1,097
Others		**860**	1,198
Interest	*16*	**147**	137
Current portions of:			
Bill deposits and related interests	*17*	**2,330**	2,555
Deferred income		**1,279**	1,004
Meter deposits and related interests	*17*	**311**	424
Refundable service extension costs		**2,261**	2,261
Dividends payable on:			
Common stock	*15*	**800**	938
Redeemable preferred stock	*17*	**250**	250
Payable to customers		**7,908**	8,136
Universal charges payable	*31*	**2,976**	2,800
FiT-All	*31*	**1,209**	925
Regulatory fees payable		**298**	182
Other current liabilities		**2,948**	3,763
		₱91,040	₱83,950

Trade Accounts Payable

Trade accounts payable mainly represent obligations to power generating companies, National Grid Corporation of the Philippines ("*NGCP*") and Philippine Electricity Market Corporation ("*PEMC*"), for cost of power purchased and transmission charge. In addition, this account includes liabilities due to local and foreign suppliers for purchases of goods and services, which include transformers, poles, materials and supplies, and contracted services.

Trade payables are non-interest-bearing and are generally settled within 15 to 60 days from the receipt of invoice. Other payables are non-interest-bearing and due within one (1) year from incurrence.

See *Note 22 – Related Party Transactions* and *Note 29 – Significant Contracts and Commitments.*

Refundable Service Extension Costs

Article 14 of the *Magna Carta*, specifically, "Right to Extension of Lines and Facilities", requires a customer requesting for an extension of lines and facilities beyond 30-meter service distance from the nearest voltage facilities of the *DU* to advance the cost of the project. The amended *DSOAR*, which became effective April 1, 2010, requires such advances from customers to be refunded at the rate of 75% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded. The related asset shall form part of the rate base only as the refund is paid out. Customer advances are non-interest-bearing.

As at June 30, 2018 and December 31, 2017, the noncurrent portion of refundable service extension costs of ₱6,554 million and ₱6,012 million, respectively, is presented as "Refundable service extension costs - net of current portion" account in the consolidated statements of financial position.

Universal Charges Payable

Universal charges are amounts passed on and collected from customers on a monthly basis by *DU*s. These are charges imposed to recover the stranded debts, stranded contract costs of *NPC* and stranded contract costs of eligible contracts of distribution. *DU*s remit collections monthly to *PSALM* who administers the fund generated from universal charges and disburses the said funds in accordance with the intended purposes.

22. Related Party Transactions

The following summarizes the total amount of transactions, which have been provided and/or contracted by the *MERALCO Group* to/with related parties for the relevant period. The outstanding balances are unsecured, non-interest-bearing and settled in cash.

Pole Attachment Contract with PLDT, Inc. ("*PLDT*")

MERALCO has a pole attachment contract with *PLDT* similar to third party pole attachment contracts of *MERALCO* with other telecommunication companies. Under the pole attachment contract, *PLDT* shall use the contracted cable position exclusively for its telecommunication cable network facilities.

Sale of Electricity under Various Service Contracts

MERALCO sells electricity to related party shareholder groups within the franchise area such as *PLDT*, *Metro Pacific* and *JG Summit* and their respective subsidiaries, and affiliates for their facilities

within *MERALCO*'s franchise area. The rates charged to related parties are the same *ERC*-mandated rates applicable to all customers within the franchise area.

Purchase of Telecommunication Services from PLDT and Subsidiaries

The *MERALCO Group*'s telecommunications carriers include *PLDT* for its wireline and Smart Communications, Inc. and Digitel Mobile Philippines, Inc., for its wireless services. Such services are covered by standard service contracts between the telecommunications carriers and each legal entity within the *MERALCO Group*.

Purchase of Goods and Services

In the ordinary course of business, the *MERALCO Group* purchases goods and services from its affiliates and sells power and renders services to such affiliates.

PSAs with Joint Ventures and Associates

As discussed in Note 29, *MERALCO* signed long-term *PSA*s with the following related parties: *SBPL*, *RP Energy*, *St. Raphael*, *Mariveles Power* and *PEDC*.

Following is a summary of related party transactions for the six months ended June 30, 2018 and 2017 and the outstanding balances as at June 30, 2018 and December 31, 2017:

	Amount of Transactions		Outstanding Receivable (Liability)			
	For the Six Months Ended June 30		**June 30,**	December 31,		
Category	**2018**	2017	**2018 (Unaudited)**	2017 (Audited)	Terms	Conditions
	(Amounts in millions)					
Sale of electricity:						
JG Summit Group	**₱1,534**	₱1,389	**₱432**	₱239	10-day; noninterest-bearing	Unsecured, no impairment
PLDT Group	**647**	486	**132**	39	10-day; noninterest-bearing	Unsecured, no impairment
Metro Pacific Group	**276**	241	**53**	6	10-day; noninterest-bearing	Unsecured, no impairment
Purchases of IT services - *Indra Philippines*	**448**	549	**(149)**	(154)	30-day; noninterest-bearing	Unsecured
Purchases of meters and devices – *Aclara Meters*	**192**	178	**(14)**	(51)	30-day; noninterest-bearing	Unsecured
Revenue from pole attachment - *PLDT*	**304**	379	**454**	160	Advance payment	Unsecured, no impairment
Purchases of wireline and wireless services - *PLDT Group*	**59**	48	**(18)**	(21)	30-day; noninterest-bearing	Unsecured
Purchases of power:						
Panay Power Corportation ("*PPC*")	**–**	145	**(1)**	(10)	30-day; noninterest-bearing	Unsecured
Toledo Power Corporation ("*TPC*")	**51**	173	**(10)**	(46)	30-day; noninterest-bearing	Unsecured
PEDC	**1,116**	730	**(506)**	(378)	30-day; noninterest-bearing	Unsecured

Advances to FPM Power

FPM Power has a non-interest-bearing loan from *MPG Asia* amounting to US$114 million as at June 30, 2018 and December 31, 2017, respectively, which is due and demandable. The loan remains outstanding as at June 30, 2018.

See *Note 14 – Other Current Assets.*

Transaction with MERALCO Retirement Benefits Fund ("*Fund*")

MERALCO's Fund holds 6,000 common shares of *RP Energy* at par value of ₱100 per share, with total carrying amount of ₱600,000 or an equivalent 3% equity interest in *RP Energy*. The fair value of *RP Energy*'s common shares cannot be reliably measured as these are not traded in the financial market. As at June 30, 2018 and December 31, 2017, the fair value of the total assets being managed by the Fund amounted to ₱35.0 billion and ₱37.2 billion, respectively.

See *Note 25 – Long-Term Employee Benefits.*

Compensation of Key Management Personnel

The compensation of key management personnel of the *MERALCO Group* by benefit type is as follows:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Short-term employee benefits	**₱449**	₱452	**₱155**	₱150
Long-term employee incentives and retirement benefits	**150**	135	**75**	67
Total compensation to key management personnel	**₱599**	₱587	**₱230**	₱217

All directors are entitled to a reasonable per diem for their attendance in meetings of the *BOD* and Board Committees plus an additional compensation, provided that the total value of such additional compensation, in whatever form so given, shall not exceed one (1) percent of the income before income tax of *MERALCO* during the preceding year.

In 2018, each of the directors is entitled to a per diem of ₱140,000 for every *BOD* meeting attended. Each member of the Audit, Risk Management, Remuneration and Leadership Development, Finance, Governance and Nomination Committees is entitled to a fee of ₱24,000 for every committee meeting attended. Also, the members of the *BOD* are entitled to a stock grant based on a pre-approved number of shares for each director which was implemented beginning May 2013 as approved by the stockholders. The directors has the option to receive the number of shares granted of the equivalent cash value.

As at June 30, 2018, there are no agreements between the *MERALCO Group* and any of its key management personnel providing for benefits upon termination of employment or retirement, except with respect to benefits provided under (i) a defined benefit retirement plan, (ii) a program which aims to address capability refresh and organizational optimization requirements, and (iii) a contributory provident plan. Post-retirement benefits under the defined benefit retirement plan

cover employees hired up to December 31, 2003 only. The provident plan, which is implemented on a voluntary basis, covers employees hired beginning January 1, 2004.

23. Purchased Power

The details of purchased power are as follows:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Generation costs	**₱97,438**	₱89,349	**₱51,744**	₱46,436
Transmission costs	**18,892**	18,334	**9,738**	9,626
	₱116,330	₱107,683	**₱61,482**	₱56,062

Purchased power costs for the captive customers are pass-through costs and are revenue-neutral to *MERALCO* and *CEDC,* as *DU*s.

Generation costs include line rentals, market fees and must-run unit charges billed by *PEMC.*

Purchased power includes, among others, capacity fees, fixed operating and maintenance fees, and transmission line fees that are accounted for similar to a lease under Philippine Interpretation *IFRIC 4,* "*Determining whether an arrangement contains a lease"*. The total amounts billed by the suppliers presented as part of "Purchased power" account in the consolidated statements of income amounted to ₱25,019 million and ₱23,953 million for the six months ended June 30, 2018 and 2017, respectively. These also include the actual *SL* incurred which is within the *SL* cap of 8.5%. *MERALCO*'s actual 12-month moving average *SL* rates are 5.71% and 6.11% for the six months ended June 30, 2018 and 2017, respectively.

The details of purchased power follow:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
First Gas Power Corporation ("*FGPC*") and FGP Corp. ("*FGP*")	**₱25,745**	₱22,367	**₱13,382**	₱11,078
NGCP	**18,787**	18,231	**9,680**	9,560
South Premiere Power Corporation ("*SPPC*")	**15,331**	15,282	**7,973**	8,268
PEMC/WESM	**16,296**	13,427	**8,788**	7,176
San Miguel Energy Corporation ("*SMEC*")	**8,769**	8,099	**4,545**	4,123
Masinloc Power Partners Co. Ltd. ("*MPPCL*")	**7,665**	6,835	**4,062**	3,633
QPPL	**7,256**	6,716	**4,202**	3,921
Therma Luzon, Inc. ("*TLI*")	**6,017**	5,197	**2,409**	2,059
Sem-Calaca Power Corporation ("*Sem-Calaca*")	**5,165**	4,753	**3,239**	2,497
Therma Mobile, Inc. ("*TMO*")	**1,695**	1,679	**842**	834

(Forward)

	Unaudited			
	For the Six Months Ended June 30		For the Three Months Ended June 30	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Southwest Luzon Power Generation Corporation	**1,185**	1,447	**933**	912
Trans-Asia Oil and Energy Development Corporation ("*Trans-Asia*")	**895**	1,121	**463**	618
PEDC	**1,063**	730	**699**	553
1590 Energy Corporation	**–**	924	**–**	592
Others	**461**	875	**265**	238
	₱116,330	₱107,683	**₱61,482**	₱56,062

Generation and transmission costs over- or under-recoveries result from the lag in the billing and recovery of generation and transmission costs from consumers. As at June 30, 2018 and December 31, 2017, the total transmission costs and *SL* charge over-recoveries included in "Other noncurrent liabilities" account in the consolidated statements of financial position amounted to ₱883 million and ₱614 million, respectively.

24. Expenses and Income

Salaries, Wages and Employee Benefits

	Note	Unaudited			
		For the Six Months Ended June 30		For the Three Months Ended June 30	
		2018	2017	**2018**	2017
		(Amounts in millions)			
Salaries, wages and related employee benefits		**₱5,858**	₱5,857	**₱2,914**	₱2,954
Retirement benefits	*25*	**497**	471	**248**	271
Other long-term post-employment benefits	*25*	**53**	55	**27**	27
		₱6,408	₱6,383	**₱3,189**	₱3,252

Other Expenses

	Note	Unaudited			
		For the Six Months Ended June 30		For the Three Months Ended June 30	
		2018	2017	**2018**	2017
		(Amounts in millions)			
Materials used	*13*	**₱1,032**	₱890	**₱593**	₱486
Rent and utilities		**380**	413	**163**	207
Insurance		**198**	182	**95**	89
Transportation and travel		**172**	187	**83**	95
Advertising		**117**	166	**35**	93
Communication	*22*	**69**	68	**37**	35
Others		**379**	475	**176**	204
		₱2,347	₱2,381	**₱1,182**	₱1,209

Interest and Other Financial Charges

	Note	**Unaudited**			
		For the Six Months Ended June 30		**For the Three Months Ended June 30**	
		2018	2017	**2018**	2017
		(Amounts in millions)			
Interest expense on interest-bearing long-term financial liabilities, net of interest capitalized	*7 and 16*	**₱476**	₱539	**₱234**	₱273
Interest expense on notes payable	*20*	**238**	153	**121**	78
Interest expense on bill deposits	*17*	**15**	32	**8**	16
Amortization of debt issuance costs	*16*	**13**	12	**6**	6
Others		**292**	14	**(17)**	6
		₱1,034	₱750	**₱352**	₱379

Interest and Other Financial Income

	Note	**Unaudited**			
		For the Six Months Ended June 30		**For the Three Months Ended June 30**	
		2018	2017	**2018**	2017
		(Amounts in millions)			
Interest income on cash in banks and cash equivalents	*11*	**₱600**	₱379	**₱308**	₱195
Income from *HTM* and *AFS* investments		**597**	651	**301**	331
Others		**13**	45	**7**	21
		₱1,210	₱1,075	**₱616**	₱547

25. Long-term Employee Benefits

Liabilities for long-term employee benefits consist of the following:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Long-term incentives	**₱3,157**	₱2,537
Retirement benefits liability	**3,160**	432
Other long-term post-employment benefits	**1,643**	1,590
	₱7,960	₱4,559

Defined Benefit Retirement Plans

The features of the *MERALCO Group*'s defined benefit plans are discussed in *Note 4 – Significant Accounting Policies, Changes and Improvements.*

Actuarial valuations are prepared annually by the respective independent actuaries engaged by *MERALCO* and its subsidiaries.

Expense recognized for defined benefit plans (included in "Salaries, wages and employee benefits" account in the consolidated statements of income)

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Current service costs	**₱476**	₱489	**₱240**	₱271
Net interest costs (income)	**4**	(45)	**(1)**	(21)
Net retirement benefits expense	**₱480**	₱444	**₱239**	₱250

Retirement Benefits Liability

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Defined benefit obligation	**₱38,249**	₱37,676
Fair value of plan assets	**(35,089)**	(37,244)
Retirement benefits liability	**₱3,160**	₱432

Changes in the net retirement benefits asset and liability are as follows:

	June 30, 2018 (Unaudited) (Six Months)	December 31, 2017 (Audited) (One year)
	(Amounts in millions)	
Retirement benefits liability (asset) at beginning of period	**₱432**	(₱1,553)
Net retirement benefits expense	**480**	772
Contributions by employer	**(8)**	(324)
Amounts recognized in *OCI*	**2,256**	1,537
Retirement benefits liability at end of period	**₱3,160**	₱432

Changes in the present value of the defined benefits obligation are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Defined benefit obligation at beginning of period	**₱37,676**	₱34,957
Interest costs	**933**	1,828
Current service costs	**476**	873
Benefits paid	**(805)**	(2,159)
Actuarial losses (gains) due to:		
Changes in financial assumptions	**(31)**	1,128
Experience adjustments	**–**	1,049
Defined benefit obligation at end of period	**₱38,249**	₱37,676

Changes in the fair value of plan assets are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Fair value of plan assets at beginning of period	**₱37,244**	₱36,510
Benefits paid	**(805)**	(2,159)
Interest income	**929**	1,929
Return on plan assets, excluding amount included in net interest on the net defined benefit obligation and interest income	**(2,287)**	640
Contributions by employer	**8**	324
Fair value of plan assets at end of period	**₱35,089**	₱37,244

The Board of Trustees ("*BoT*") which manages the *Fund*, is chaired by the Chairman of *MERALCO*, who is neither an executive nor a beneficiary. The other members of the *BoT* are (i) an executive member of the *BOD*; (ii) three (3) senior executives ; (iii) an independent member of the *BOD*; and (iv) a member of the *BOD* who represents the largest shareholder group, all of whom are not beneficiaries of the plan.

The *Fund* follows a conservative approach by investing in fixed income, money market and equity assets to diversify the portfolio in order to minimize risk while maintaining an adequate rate of return. The assets of the *Fund* are managed by four (4) local and one (1) foreign trustee banks whose common objective is to maximize the long-term expected return of plan assets. The *BoT*, periodically reviews and approves the strategic mandate of the portfolio to ensure the ability of the *Fund* to service its short-term and long-term obligations.

The net carrying amount and fair value of the assets of the *Fund* as at June 30, 2018 and December 31, 2017 amounted to ₱35,089 million and ₱37,244 million, respectively. The major categories of plan assets are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amount in millions)	
Cash and cash equivalents	**₱1,597**	₱1,715
Investments quoted in active markets:		
Quoted equity investments		
Holding firms	**2,984**	3,607
Banks	**914**	924
Telecommunication	**808**	937
Electricity, energy, power and water	**788**	893
Property	**759**	934
Food, beverages and tobacco	**396**	653
Retail	**329**	367
Construction, infrastructure and allied services	**199**	223
Transportation services	**188**	212
Mining	**172**	232
Others	**1,610**	1,517
Quoted debt investments		
"AAA" rated securities	**13,764**	14,085
Government securities	**8,228**	8,517

(Forward)

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amount in millions)	
Unquoted investments		
Receivables	**1,338**	1,473
Others	**1**	1
Real property	**1,014**	954
Fair value of plan assets	**₱35,089**	₱37,244

Marketable equity securities, government securities, bonds and commercial notes are investments held by the trustee banks.

Other Long-term Post-employment Benefits (included as part of "Salaries, wages and employee benefits" account in the consolidated statements of income)

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Interest costs	**₱40**	₱42	**₱20**	₱21
Current service costs	**13**	13	**7**	6
	₱53	₱55	**₱27**	₱27

Other Long-term Post-employment Benefits Liability

Changes in the present value of other long-term post-employment benefits liability are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Balance at beginning of period	**₱1,590**	₱1,568
Interest costs	**40**	85
Current service costs	**13**	25
Benefits paid	**–**	(55)
Actuarial gains due to change in assumptions	**–**	(33)
Balance at end of period	**₱1,643**	₱1,590

Actuarial Assumptions

The principal assumptions used as at June 30, 2018 and December 31, 2017 in determining retirement benefits and other long-term post-employment benefits obligations are shown below:

	2018	2017
Annual discount rate	**5%**	5%
Future range of annual salary increases	**6%**	6%

Sensitivity Analysis

The calculation of the defined benefit obligation is sensitive to the assumptions set above. The following table summarizes how the impact on the defined benefit obligation at the end of the reporting period would have increased (decreased) as a result of a change in the respective assumptions by:

		Effect on Present Value of Defined Benefit Obligation	
	% Change	**2018**	2017
		(Amounts in millions)	
Annual discount rate	+1.0%	**(₱2,233)**	(₱2,661)
	-1.0%	**2,233**	2,658
Future range of annual salary increases	+1.0%	**1,264**	1,666
	-1.0%	**(1,263)**	(1,665)

Funding

MERALCO contributes to the *Fund* from time to time such amounts of money required under accepted actuarial principles to maintain the Fund in a sound condition, subject to the provisions of the Plan.

The amount of the annual contributions to the *Fund* is determined through an annual valuation report performed by an independent actuary.

The following is the maturity profile of the undiscounted benefit obligation as at June 30, 2018:

	Amounts in millions
Less than one (1) year	₱1,841
One (1) year up to five (5) years	8,242
More than five (5) years up to 10 years	14,715
More than 10 years up to 15 years	19,271
More than 15 years up to 20 years	19,221
More than 20 years	56,428

Risk

The *Fund* is exposed to the following risks:

Credit Risk
The *Fund*'s exposure to credit risk arises from its financial assets which comprise of cash and cash equivalents, investments and rental receivable. The credit risk results from the possible default of the issuer of the financial instrument, with a maximum exposure equivalent to the carrying amounts of the instruments.

The credit risk is minimized by ensuring that the exposure to the various chosen financial investment structures is limited primarily to government securities and bonds or notes duly recommended by the Trust Committees of the appointed fund managers of the *Fund*.

Share Price Risk
The *Fund*'s exposure to share price risk arises from the shares of stock it holds and are traded at the *PSE*. The price share risk emanates from the volatility of the stock market.

The policy is to limit investment in shares of stock to blue chip issues or issues with good fair values or those trading at a discount to its net asset value so that in the event of a market downturn, the *Fund* may still consider to hold on to such investments until the market recovers.

By having a balanced composition of holdings in the equities portfolio, exposure to industry or sector-related risks is reduced. The mix of various equities in the portfolio reduces volatility and contributes to a more stable return over time. Equity investments are made within the parameters of the investment guidelines approved by the *BoT*. The *BoT* also meets periodically to review the investment portfolio based on financial market conditions. Share prices are also monitored regularly.

Liquidity Risk
Liquidity risk is the risk that the *Fund* is unable to meet its payment obligations associated with its financial liabilities as they fall due and to replace funds when they are withdrawn. Liquidity risk is being managed to ensure that adequate fixed income and cash deposits are available to service the financial obligations of the *Fund*. The schedule of the maturities of fixed income investment assets are staggered by tenure or term. Policies are established to ensure that all financial obligations are met, wherein the timing of the maturities of fixed income investments are planned and matched to the due date of various obligations. Thus, for this investment class, maturities are classified into short-, medium- and long-term. A certain percentage of the portfolio is kept as cash to manage liquidity and settle all currently maturing financial obligations.

Defined Contribution Provident Plan

MERALCO has a defined contributory Provident Plan effective January 1, 2009, intended to be a Supplemental retirement benefit for employees hired beginning 2004, the participation of which is voluntary. Each qualified employee-member who chooses to participate in the plan shall have the option to contribute up to a maximum of 25% of his base salary. *MERALCO* shall match the member's contribution up to 100% of employee's contribution or 10% of the member's monthly base salary, subject to a certain threshold. Upon resignation, the member shall be entitled to the total amount credited to his personal retirement account immediately preceding his actual retirement date, subject to provisions of the Provident Plan. *MERALCO*'s contribution to the Provident Plan amounted to ₱17 million and ₱27 million for the six months ended June 30, 2018 and 2017, respectively.

Consolidated Retirement Benefits Cost (included in "Salaries, wages and employee benefits" account in the consolidated statements of income)

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Expense recognized for defined benefit plans	**₱480**	₱444	**₱239**	₱250
Expense recognized for defined contribution plan	**17**	27	**9**	21
Retirement benefits expense	**₱497**	₱471	**₱248**	₱271

Long-term Incentive Plan ("*LTIP*")

MERALCO's *LTIP* covers qualified employees and is based on the *MERALCO Group*'s achievement of specified level of *CCNI* approved by the *BOD* and determined on an aggregate basis for a three (3)-year period as well as employees' attainment of a minimum level of performance rating. Employees invited to *LTIP* must serve a minimum uninterrupted period to be entitled to an award. Further, the employee should be on active employment at the time of pay-out.

26. Financial Assets and Financial Liabilities

Financial assets consist of cash and cash equivalents, short-term investments and trade and other receivables, which are generated directly from operations, advances to an associate, *AFS* financial assets and *HTM* investments. The principal financial liabilities consist of bank loans, redeemable preferred shares, trade and nontrade payables, which are incurred to finance operations in the normal course of business. Accounting policies related to financial assets and financial liabilities are set out in *Note 4 – Significant Accounting Policies, Changes and Improvements*.

The following table sets forth the financial assets and financial:

	Loans and Receivables	*HTM* Investments	Fair Value through Profit or Loss	Held-for-trading	*AFS* Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities
			(Amounts in millions)				
Assets as at June 30, 2018 (Unaudited)							
Noncurrent							
Other noncurrent assets	**₱3,506**	**₱30,959**	**₱–**	**₱–**	**₱3,970**	**₱–**	**₱38,435**
Current							
Cash and cash equivalents	**50,778**	**–**	**–**	**–**	**–**	**–**	**50,778**
Trade and other receivables	**27,670**	**–**	**–**	**–**	**–**	**–**	**27,670**
Other current assets	**14,782**	**2,148**	**–**	**–**	**–**	**–**	**16,930**
Total assets	**₱96,736**	**₱33,107**	**₱–**	**₱–**	**₱3,970**	**₱–**	**₱133,813**
Liabilities as at June 30, 2018 (Unaudited)							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	**₱–**	**₱–**	**₱–**	**₱–**	**₱–**	**₱24,410**	**₱24,410**
Customers' deposits - net of current portion	**–**	**–**	**–**	**–**	**–**	**25,165**	**25,165**
Refundable service extension costs - net of current portion	**–**	**–**	**–**	**–**	**–**	**6,554**	**6,554**
Current							
Notes payable	**–**	**–**	**–**	**–**	**–**	**13,634**	**13,634**
Trade payables and other current liabilities	**–**	**–**	**–**	**–**	**–**	**57,702**	**57,702**
Customers' refund	**–**	**–**	**–**	**–**	**–**	**4,453**	**4,453**
Current portion of interest-bearing long-term financial liabilities	**–**	**–**	**–**	**–**	**–**	**1,838**	**1,838**
Total liabilities	**₱–**	**₱–**	**₱–**	**₱–**	**₱–**	**₱133,756**	**₱133,756**

	Loans and Receivables	*HTM* Investments	Fair Value through Profit or Loss	Held-for-trading	*AFS* Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities
			(Amounts in millions)				
Assets as at December 31, 2017 (Audited)							
Noncurrent							
Other noncurrent assets	₱3,563	₱27,180	₱–	₱–	₱4,360	₱–	₱35,103
Current							
Cash and cash equivalents	45,937	–	–	–	–	–	45,937
Trade and other receivables	26,288	–	–	–	–	–	26,288
Other current assets	8,413	9,001	–	–	–	–	17,414
Total assets	₱84,201	₱36,181	₱–	₱–	₱4,360	₱–	₱124,742
Liabilities as at December 31, 2017 (Audited)							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	₱–	₱–	₱–	₱–	₱–	₱24,786	₱24,786
Customers' deposits - net of current portion	–	–	–	–	–	24,000	24,000
Refundable service extension costs - net of current portion	–	–	–	–	–	6,012	6,012
Current							
Notes payable	–	–	–	–	–	13,586	13,586
Trade payables and other current liabilities	–	–	–	–	–	50,665	50,665
Customers' refund	–	–	–	–	–	4,603	4,603
Current portion of interest-bearing long-term financial liabilities	–	–	–	–	–	1,884	1,884
Total liabilities	₱–	₱–	₱–	₱–	₱–	₱125,536	₱125,536

Fair Values

The fair values of the financial assets and financial liabilities are amounts that would be received to sell the financial assets or paid to transfer the financial liabilities in orderly transactions between market participants at the measurement date. Set out below is a comparison of carrying amounts and fair values of the *MERALCO Group*'s financial instruments:

	June 30, 2018 (Unaudited)		December 31, 2017 (Audited)	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
		(Amounts in millions)		
Financial assets				
Loans and receivables -				
Advance payments to a supplier	**₱3,696**	**₱3,655**	₱3,741	₱3,451
AFS financial assets	**3,970**	**3,970**	4,360	4,360
HTM investments	**33,107**	**31,192**	36,181	35,172
	₱40,773	**₱38,817**	₱44,282	₱42,983
Financial liabilities				
Financial liabilities carried at amortized cost -				
Interest-bearing-long-term financial liabilities	**₱26,248**	**₱27,325**	₱26,670	₱27,806

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and Cash Equivalents, Trade and Other Receivables, Short-term Investments, Advances to an Associate, Trade Payables and Other Current Liabilities and Notes Payable

Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as at reporting date.

Advance Payments to a Supplier

The fair values of advance payments to a supplier were computed by discounting the instruments' expected future cash flows using the rates of 5.76% and 4.74% as at June 30, 2018 and December 31, 2017, respectively.

AFS Financial Assets

The fair values were determined by reference to market bid quotes as at reporting date. The unquoted equity securities were carried at cost since there are no available market price for such securities.

HTM Investments

The fair values were determined by discounting the expected future cash flows using the interest rate as at reporting date.

Meter Deposits and Customers' Refund

Meter deposits and customers' refund are due and demandable. Thus, the fair values of these instruments approximate their carrying amounts.

Bill Deposits

The carrying amounts of bill deposits approximate their fair values as bill deposits are interest-bearing.

Interest-bearing Long-term Financial Liabilities

The fair values of interest-bearing long-term debt (except for redeemable preferred stock) were computed by discounting the instruments' expected future cash flows using the rates ranging from 0.12% to 4.06% as at June 30, 2018 and 0.11% to 4.09% as at December 31, 2017.

Redeemable Preferred Stock

The carrying amount of the preferred stock represents the fair value. Such preferred shares have been called and are payable anytime upon presentation by the shareholder of their certification. This is included under "Interest-bearing long-term financial liabilities" account.

Refundable Service Extension Costs

The fair values of refundable service extension costs cannot be reliably measured since the timing of related cash flows cannot be reasonably estimated and are accordingly measured at cost.

Fair Value Hierarchy

Below is the list of financial assets and financial liabilities that are classified using the fair value hierarchy:

	June 30, 2018 (Unaudited)				December 31, 2017 (Audited)			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
				(Amounts in millions)				
Financial assets								
Advance payments to a supplier and others	**₱–**	**₱3,655**	**₱–**	**₱3,655**	₱–	₱3,451	₱–	₱3,451
AFS financial assets	**3,926**	**44**	**–**	**3,970**	4,321	39	–	4,360
HTM investments	**31,192**	**–**	**–**	**31,192**	35,172	–	–	35,172
	₱35,118	**₱3,699**	**₱–**	**₱38,817**	₱39,493	₱3,490	₱–	₱42,983
Financial liabilities								
Interest-bearing long-term financial liabilities	**₱–**	**₱27,325**	**₱–**	**₱27,325**	₱–	₱27,806	₱–	₱27,806

For the six months ended June 30, 2018 and 2017, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into or out of Level 3 fair value measurements.

Financial Risk Management Objectives and Policies

The main risks arising from the financial instruments are interest rate risk, foreign currency risk, commodity price risk, credit risk and liquidity risk. The importance of managing these risks has significantly increased in light of the considerable change and volatility in the Philippine and international financial markets. The *BOD* reviews and approves policies for managing each of these risks. Management monitors the market price risk arising from all financial instruments. The policies for managing these risks are as follows:

Interest Rate Risk

The *MERALCO Group'*s exposure to the changes in market interest rates relate primarily to the long-term interest-bearing financial liabilities.

The *MERALCO Group'*s policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts. The strategy, which yields a reasonably lower effective cost based on market conditions, is adopted. Refinancing of fixed rate loans may also be undertaken to manage interest cost. All borrowings bear fixed rate of interest as at June 30, 2018 and December 31, 2017.

Foreign Currency Risk

The revaluation of any of foreign currency-denominated financial assets and financial liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the end of each reporting period. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency-denominated financial instruments. While an insignificant percentage of the *MERALCO Group*'s revenues and liabilities is denominated in *U.S.* dollars, a substantial portion of the *MERALCO Group*'s expenditures for electricity capital projects and a portion of the operating expenses are denominated in foreign currencies, mostly in *U.S.* dollars. As such, a strengthening or weakening of the Philippine peso against the *U.S.* dollar will decrease or increase in Philippine peso terms, the principal amount of the *MERALCO Group*'s foreign currency-denominated liabilities and the related interest expense, foreign currency-denominated capital expenditures and operating expenses as well as *U.S.* dollar-denominated revenues.

The following table shows the consolidated foreign currency-denominated financial assets and financial liabilities as at June 30, 2018 and December 31, 2017, translated to Philippine peso at ₱53.34 and ₱49.93 to US$1, respectively.

	June 30, 2018 (Unaudited)		December 31, 2017 (Audited)	
	U.S. Dollar	**Peso Equivalent**	U.S. Dollar	Peso Equivalent
		(Amounts in millions)		
Financial assets:				
Cash and cash equivalents	**$155**	**₱8,250**	$218	₱10,876
Trade and other receivables	**2**	**105**	2	104
Other current assets	**123**	**6,571**	50	2,497
AFS financial assets	**5**	**267**	5	250
Advances to an associate	**114**	**6,055**	114	5,668
Advance payments to suppliers	**55**	**2,913**	55	2,762
	454	**24,161**	444	22,157
Financial liabilities -				
Trade payables and other liabilities	**(8)**	**(415)**	(4)	(182)
	$446	**₱23,746**	$440	₱21,975

All of the *MERALCO Group*'s long-term financial liabilities are denominated in Philippine peso. However, an insignificant portion of its trade payables are denominated in *U.S.* dollar. Thus, the impact of ₱1 movement of the Philippine peso against the *U.S.* dollar will not have a significant impact on the *MERALCO Group*'s obligations.

The following table demonstrates the sensitivity to a reasonably possible change in the *U.S.* dollar exchange rate vis-a-vis the Philippine peso, with all other variables held constant, of the *MERALCO Group*'s income before income tax for the six months ended June 30, 2018 and 2017 (due to changes in the fair value of financial assets and financial liabilities). There is no other impact on the *MERALCO Group*'s equity other than those already affecting the consolidated statements of income.

	For the Six Months Ended June 30			
	2018		2017	
	Appreciation (Depreciation) of U.S. Dollar	**Effect on Income before Income Tax**	Appreciation (Depreciation) of U.S. Dollar	Effect on Income before Income Tax
	(In %)	*(In millions)*	*(In %)*	*(In millions)*
U.S. dollar-denominated financial assets and financial liabilities	**+5**	**₱1,189**	+5	₱1,099
	–5	**(1,189)**	–5	(1,099)

Foreign exchange gain or loss for the period is computed based on management's best estimate of a +/–5 percent change in the closing Philippine peso to *U.S.* dollar conversion rate using the balances as at financial reporting date of *U.S.* dollar-denominated cash and cash equivalents, receivables and other assets and liabilities. There has been no change in the methods and assumptions used by management in the above analysis.

Commodity Price Risk

Commodity price risk is the risk that the fair value or cash flows of a financial instrument will fluctuate because of changes in world prices or index of the commodity. The exposure of *MERALCO* and *CEDC* to price risk is minimal. The cost of fuel is part of *MERALCO*'s and *CEDC*'s generation costs that are recoverable through the generation charge in the billings to customers.

Credit Risk

Credit risk is the risk that the *MERALCO Group* is exposed to, as a result of its customers, clients or counterparties failing to discharge their contracted obligations. The *MERALCO Group* manages and controls credit risk by setting limits on the amount of risk that it is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

MERALCO as a franchise holder serving public interest cannot refuse customer connection. To mitigate risk, the *DSOAR* allows *MERALCO* to collect bill deposit equivalent to one (1) month's consumption to secure credit. Also, as a policy, disconnection notices are sent three (3) days after the bill due date and disconnections are carried out beginning on the third day after receipt of disconnection notice.

The subsidiaries of *MERALCO* trade only with recognized, creditworthy third parties. It is the *MERALCO Group*'s policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivables are monitored on an ongoing basis to reduce exposure to bad debt.

With respect to placements of cash with financial institutions, these institutions are subject to the *MERALCO Group*'s accreditation evaluation based on liquidity and solvency ratios and on the bank's credit rating. The *MERALCO Group* transacts derivatives only with similarly accredited financial institutions. In addition, the *MERALCO Group'*s deposit accounts in banks are insured by the Philippine Deposit Insurance Corporation up to ₱500,000 per bank account.

Credit risk on other financial assets, which include cash and cash equivalents and trade and other receivables, arises from the potential default of the counterparty.

Finally, credit quality review procedures are in place to provide regular identification of changes in the creditworthiness of counterparties. Counterparty limits are established and reviewed periodically based on latest available financial information of counterparties, credit ratings and liquidity. The *MERALCO Group*'s credit quality review process allows it to assess any potential loss as a result of the risks to which it may be exposed and to take corrective actions.

There are no significant concentrations of credit risk within the *MERALCO Group*.

The table below shows the maximum exposure to credit risk for the components of the consolidated statements of financial position. The maximum exposure is equivalent to the nominal amount of the accounts.

	Gross Maximum Exposure	
	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Cash and cash equivalents:		
Cash in banks	**₱8,619**	₱6,118
Cash equivalents	**41,685**	39,759
Trade and other receivables:		
Electricity	**22,040**	20,198
Service contracts	**3,125**	3,973
Cost and estimated earnings in excess of billings on uncompleted contracts	**952**	753
Nontrade receivables	**1,553**	1,364
Other current assets:		
Short-term investments	**8,592**	2,532
Advances to an associate	**6,000**	5,703
HTM investments	**2,148**	9,001
Current portion of advance payments to a supplier	**190**	178
Other noncurrent assets:		
HTM investments	**30,959**	27,180
AFS financial assets	**3,970**	4,360
Advance payment to a supplier and others	**3,506**	3,563
	₱133,339	₱124,682

The credit quality of financial assets is managed by *MERALCO* using "High Grade", "Standard Grade" and "Sub-standard Grade" for accounts, which are neither impaired nor past due using internal credit rating policies.

The following tables show the credit quality by asset class:

	June 30, 2018 (Unaudited)					
	Neither Past Due nor Impaired					
	High Grade	**Standard Grade**	**Sub-standard Grade**	**Past Due but not Impaired**	**Impaired Financial Assets**	**Total**
	(Amounts in millions)					
Cash in banks and cash equivalents	**₱50,304**	**₱–**	**₱–**	**₱–**	**₱–**	**₱50,304**
Trade and other receivables:						
Electricity	**5,791**	**2,601**	**11,094**	**2,554**	**1,599**	**23,639**
Service contracts	**1,264**	**–**	**95**	**1,766**	**230**	**3,355**
Cost and estimated earnings in excess of billings on uncompleted contracts	**–**	**–**	**569**	**383**	**6**	**958**
Nontrade receivables	**958**	**2**	**–**	**593**	**2**	**1,555**
Other current assets:						
Short-term investments	**8,592**	**–**	**–**	**–**	**–**	**8,592**
Advances to an associate	**6,000**	**–**	**–**	**–**	**–**	**6,000**
HTM investments	**2,148**	**–**	**–**	**–**	**–**	**2,148**
Current portion of advance payments to a supplier	**190**	**–**	**–**	**–**	**–**	**190**
Other noncurrent assets:						
HTM investments	**30,959**	**–**	**–**	**–**	**–**	**30,959**
AFS financial assets	**3,970**	**–**	**–**	**–**	**–**	**3,970**
Advance payment to a supplier and others	**3,506**	**–**	**–**	**–**	**–**	**3,506**
	₱113,682	**₱2,603**	**₱11,758**	**₱5,296**	**₱1,837**	**₱135,176**

	December 31, 2017 (Audited)					
	Neither Past Due nor Impaired					
	High Grade	Standard Grade	Sub-standard Grade	Past Due but not Impaired	Impaired Financial Assets	Total
	(Amounts in millions)					
Cash in banks and cash equivalents	₱45,877	₱–	₱–	₱–	₱–	₱45,877
Trade and other receivables:						
Electricity	4,817	2,089	9,438	3,854	3,307	23,505
Service contracts	1,443	–	186	2,344	223	4,196
Cost and estimated earnings in excess of billings on uncompleted contracts	–	–	453	300	6	759
Nontrade receivables	895	26	173	270	2	1,366
Other current assets:						
HTM investments	9,001	–	–	–	–	9,001
Advances to an associate	5,703	–	–	–	–	5,703
Short-term investments	2,532	–	–	–	–	2,532
Current portion of advance payments to a supplier	178	–	–	–	–	178
Other noncurrent assets:						
HTM investments	27,180	–	–	–	–	27,180
AFS financial assets	4,360	–	–	–	–	4,360
Advance payment to a supplier and others	3,563	–	–	–	–	3,563
	₱105,549	₱2,115	₱10,250	₱6,768	₱3,538	₱128,220

Credit ratings are determined as follows:

- High Grade

  High grade financial assets include cash in banks, cash equivalents, advances to associates, *HTM*, *AFS* and advance payments to a supplier to counterparties with good credit rating or bank standing. Consequently, credit risk is minimal. These counterparties include large prime financial institutions, large industrial companies and commercial establishments, and government agencies. For trade receivables, these consist of current month's billings (less than 30 days) that are expected to be collected within 10 days from the time bills are delivered.

- Standard Grade

  Standard grade financial assets include trade receivables that consist of current month's billings (less than 30 days) that are expected to be collected before due date (10 to 14 days after bill date).

- Sub-standard Grade

  Sub-standard grade financial assets include trade receivables that consist of current month's billings, which are not expected to be collected within 60 days.

The following table shows the aging analysis of financial:

	June 30, 2018 (Unaudited)					
	Neither Past Due nor Impaired	**Past Due But Not Impaired**			**Impaired Financial Assets**	**Total**
		31–60 Days	**61–90 Days**	**Over 90 Days**		
	(Amounts in millions)					
Cash and cash equivalents:						
Cash equivalents	**₱8,619**	**₱–**	**₱–**	**₱–**	**₱–**	**₱8,619**
Cash in banks	**41,685**	**–**	**–**	**–**	**–**	**41,685**
Trade and other receivables:						
Trade:						
Electricity	**19,486**	**766**	**203**	**1,585**	**1,599**	**23,639**
Service contracts	**1,359**	**93**	**16**	**1,657**	**230**	**3,355**
Cost and estimated earnings in excess of billings on uncompleted contracts	**569**	**84**	**67**	**232**	**6**	**958**
Nontrade receivables	**960**	**31**	**403**	**159**	**2**	**1,555**
Other current assets:						
Short-term investments	**8,592**	**–**	**–**	**–**	**–**	**8,592**
Advances to an associate	**6,000**	**–**	**–**	**–**	**–**	**6,000**
HTM investments	**2,148**	**–**	**–**	**–**	**–**	**2,148**
Current portion of advance payments to a supplier	**190**	**–**	**–**	**–**	**–**	**190**
Other noncurrent assets:						
HTM investments	**30,959**	**–**	**–**	**–**	**–**	**30,959**
AFS financial assets	**3,970**	**–**	**–**	**–**	**–**	**3,970**
Advance payments to a supplier and others	**3,506**	**–**	**–**	**–**	**–**	**3,506**
	₱128,043	**₱974**	**₱689**	**₱3,633**	**₱1,837**	**₱135,176**

	December 31, 2017 (Audited)					
	Neither Past Due nor Impaired	Past Due But Not Impaired			Impaired Financial Assets	Total
		31–60 Days	61–90 Days	Over 90 Days		
	(Amounts in millions)					
Cash and cash equivalents:						
Cash equivalents	₱6,118	₱–	₱–	₱–	₱–	₱6,118
Cash in banks	39,759	–	–	–	–	39,759
Trade and other receivables:						
Trade:						
Electricity	16,344	753	251	2,850	3,307	23,505
Service contracts	1,629	183	28	2,133	223	4,196
Cost and estimated earnings in excess of billings on uncompleted contracts	453	67	47	186	6	759
Nontrade receivables	1,094	36	60	174	2	1,366
Other current assets:						
HTM investments	9,001	–	–	–	–	9,001
Advances to an associate	5,703	–	–	–	–	5,703
Short-term investments	2,532	–	–	–	–	2,532
Current portion of advance payments to a supplier	178	–	–	–	–	178
Other noncurrent assets:						
HTM investments	27,180	–	–	–	–	27,180
AFS financial assets	4,360	–	–	–	–	4,360
Advance payments to a supplier and others	3,563	–	–	–	–	3,563
	₱117,914	₱1,039	₱386	₱5,343	₱3,538	₱128,220

Liquidity Risk

Liquidity risk is the risk that the *MERALCO Group* will be unable to meet its payment obligations when these fall due. The *MERALCO Group* manages this risk through monitoring of cash flows in consideration of future payment of obligations and the collection of its trade receivables. The *MERALCO Group* also ensures that there are sufficient, available and approved working capital lines that it can draw from at any time.

The *MERALCO Group* maintains an adequate amount of cash, cash equivalents and *AFS* financial assets, which may be readily converted to cash in any unforeseen interruption of its cash collections. The *MERALCO Group* also maintains accounts with several relationship banks to avoid significant concentration of funds with one (1) institution.

The following table sets out the maturity profile of the financial liabilities based on contractual undiscounted payments plus future interest:

	June 30, 2018 (Unaudited)				
	Less than 3 Months	**Over 3–12 Months**	**Over 1–5 Years**	**More than 5 Years**	**Total**
			(Amounts in millions)		
Notes payable	**₱1,129**	**₱12,867**	**₱–**	**₱–**	**₱13,996**
Trade payables and other current liabilities	**52,800**	**–**	**–**	**–**	**52,800**
Customers' refund	**4,453**	**–**	**–**	**–**	**4,453**
Interest-bearing long-term financial liabilities:					
Fixed rate borrowings	**223**	**1,160**	**16,129**	**12,372**	**29,884**
Redeemable preferred stock	**1,493**	**–**	**–**	**–**	**1,493**
Customers' deposits	**665**	**1,976**	**5,329**	**19,835**	**27,805**
Refundable service extension costs	**345**	**1,916**	**4,405**	**2,149**	**8,815**
Total undiscounted financial liabilities	**₱61,108**	**₱17,919**	**₱25,863**	**₱34,356**	**₱139,246**

	December 31, 2017 (Audited)				
	Less than 3 Months	Over 3–12 Months	Over 1–5 Years	More than 5 Years	Total
			(Amounts in millions)		
Notes payable	₱1,080	₱12,867	₱–	₱–	₱13,947
Trade payables and other current liabilities	45,425	–	–	–	45,425
Customers' refund	4,603	–	–	–	4,603
Interest-bearing long-term financial liabilities:					
Fixed rate borrowings	324	1,202	16,423	13,032	30,981
Redeemable preferred stock	1,496	–	–	–	1,496
Customers' deposits	1,094	1,885	5,089	18,911	26,979
Refundable service extension costs	84	2,177	4,646	1,366	8,273
Total undiscounted financial liabilities	₱54,106	₱18,131	₱26,158	₱33,309	₱131,704

The maturity profile of bill deposits is not determinable since the timing of each refund is linked to the cessation of service, which is not reasonably predictable. However, *MERALCO* estimates that the amount of bill deposits (including related interests) of ₱2,330 million will be refunded within a year. This is shown as part of "Trade payables and other current liabilities" account in the consolidated statements of financial position as at June 30, 2018.

Capital Management

The primary objective of the *MERALCO Group*'s capital management is to enhance shareholder value. The capital structure is reviewed with the end view of achieving a competitive cost of capital and at the same time ensuring that returns on, and of, capital are consistent with the levels approved by its regulators for its core distribution business.

The capital structure optimization plan is complemented by efforts to improve capital efficiency to increase yields on invested capital. This entails efforts to improve the efficiency of capital assets, working capital and non-core assets.

The *MERALCO Group* monitors capital using, among other measures, debt to equity ratio, which is gross debt divided by equity attributable to the holders of the parent. The *MERALCO Group* considers long-term debt, redeemable preferred stock and notes payable as debt.

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions, except debt to equity ratio)	
Long-term debt	**₱24,755**	₱25,174
Redeemable preferred stock	**1,493**	1,496
Notes payable	**13,634**	13,586
Debt (a)	**₱39,882**	₱40,256
Equity attributable to the holders of the parent (b)	**₱75,118**	₱73,610
Debt to equity ratio(a)/(b)	**0.53**	0.55

27. Income Taxes and Local Franchise Taxes

Income Taxes

The components of net deferred tax assets and liabilities are as follows:

	Note	**June 30, 2018 (Unaudited)**	December 31, 2017 (Audited)
		(Amounts in millions)	
Deferred tax assets:			
Provisions for various claims	*18 and 21*	**₱24,757**	₱23,021
Accrued employee benefits	*25*	**1,437**	1,235
Unfunded retirement benefits cost and unamortized past service cost	*25*	**1,194**	1,056
Allowance for doubtful accounts	*12*	**325**	615
Allowance for excess of cost over net realizable value of inventories	*13*	**58**	58
Others		**180**	166
		27,951	26,151
Deferred tax liabilities:			
Revaluation increment in utility plant and others	*15*	**6,970**	6,994
Capitalized interest		**751**	733
Actuarial gains	*25*	**349**	1,035
Capitalized duties and taxes deducted in advance		**663**	631
Depreciation method differential		**395**	434
Others		**393**	230
		9,521	10,057
		₱18,430	₱16,094

The deferred tax assets and liabilities are presented in the consolidated statements of financial position as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Deferred tax assets - net	**₱18,490**	₱16,146
Deferred tax liabilities - net	**(60)**	(52)
	₱18,430	₱16,094

Provision for (benefit from) income tax consists of:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Current	**₱5,177**	₱5,389	**₱2,605**	₱3,178
Deferred	**(1,643)**	(1,368)	**(1,110)**	(971)
	₱3,534	₱4,021	**₱1,495**	₱2,207

The deferred tax assets charged directly to *OCI* amounted to ₱669 million (benefit) and ₱18 million (expense) for the six months ended June 30, 2018 and 2017, respectively.

A reconciliation between the provision for income tax computed at statutory income tax rate of 30% for the six months ended June 30, 2018 and 2017, and provision for income tax as shown in the consolidated statements of income is as follows:

	Unaudited			
	For the Six Months Ended June 30		**For the Three Months Ended June 30**	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Income tax computed at statutory tax rate	**₱4,659**	₱4,377	**₱2,455**	₱2,378
Income tax effects of:				
Interest income subjected to lower final tax rate	**(361)**	(321)	**(184)**	(169)
Nondeductible interest expense	**149**	132	**76**	69
Nontaxable income	**(125)**	(45)	**(89)**	(40)
Equity in net losses (earnings) of associates and joint ventures	**44**	(69)	**84**	(28)
Others	**(832)**	(53)	**(847)**	(3)
	₱3,534	₱4,021	**₱1,495**	₱2,207

On December 18, 2009, the *BIR* issued Revenue Regulations ("*RR*") No. 16-2008, which implemented the provisions of *RA* No. 9504 on Optional Standard Deductions ("*OSD*"). Such regulation allows both individual and corporate taxpayers to use *OSD* in computing their taxable income. For corporations, they may elect to adopt standard deduction in an amount not exceeding 40% of gross income in lieu of the allowed itemized deductions. In 2018 and 2017, *MERALCO*

elected to adopt the *OSD* in lieu of itemized deductions beginning with its first quarter income tax return.

Certain deferred tax assets and liabilities expected to be recovered or settled in taxable year 2018, for which the related income and expense are not considered in determining gross income for income tax purposes, are not recognized. This is because the manner by which *MERALCO* expects to recover or settle the underlying assets and liabilities would not result to any future tax consequence under the *OSD* method.

Meanwhile, certain deferred tax assets and liabilities expected to be recovered or settled in taxable year 2018, for which the related income and expense are considered in determining gross income for income tax purposes, are recognized only to the extent of their future tax consequence under *OSD* method. Hence, the tax base of these deferred income tax assets and liabilities is reduced by the 40% allowable deduction provided for under the *OSD* method resulting into an adjusted tax rate of 18% from 30%.

Accordingly, *MERALCO*'s net deferred tax assets as at June 30, 2018 and December 31, 2017, which were not recognized due to the expected use of the *OSD* method in the taxable year 2018 are as follows:

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
	(Amounts in millions)	
Deferred tax assets:		
Allowance for doubtful accounts	**₱222**	₱375
Provisions for various claims	**–**	287
Others	**38**	55
	260	717
Deferred tax liabilities:		
Depreciation method differential	**43**	66
Revaluation increment in utility plant and others	**27**	57
Capitalized interest	**14**	27
Capitalized duties and taxes deducted in advance	**13**	24
Others	**3**	10
	100	184
	₱160	₱533

The temporary difference for which deferred tax assets have not been recognized pertains to the tax effect of net operating loss carryover ("*NOLCO*") amounting to ₱1,678 million and ₱1,406 million as at June 30, 2018 and December 31, 2017, respectively. These are not recognized because the Company does not expect to utilize such deferred tax assets against sufficient taxable profit.

NOLCO totaling to ₱1,678 million may be claimed as deduction against taxable income as follows:

Date Incurred	Expiry Date	Amount
		(In millions)
December 31, 2015	December 31, 2018	₱322
December 31, 2016	December 31, 2019	465
December 31, 2017	December 31, 2020	613
June 30, 2018	June 30, 2021	278
		₱1,678

NOLCO amounting to ₱500 million and ₱402 million expired in 2017 and 2016, respectively.

LFT

Consistent with the decisions of the *ERC*, *LFT* is a recoverable charge of the *DU* in the particular province or city imposing and collecting the *LFT*. It is presented as a separate line item in the customer's bill and computed as a percentage of the sum of generation, transmission, distribution services and related *SL* charges.

The *IRR* issued by the *ERC* provide that *LFT* shall be paid only on its distribution wheeling and captive market supply revenues. Pending the promulgation of guidelines from the relevant government agencies, *MERALCO* is paying *LFT* based on the sum of the foregoing charges in the customers' bill.

28. Contingencies and Legal Proceedings

Overpayment of Income Tax related to SC Refund

With the decision of the *SC* for *MERALCO* to refund ₱0.167 per *kWh* to customers during the billing period February 1994 to May 2003, *MERALCO* overpaid income tax in the amount of ₱7,107 million for taxable years 1994 to 1998 and 2000 to 2001. Accordingly, on November 27, 2003, *MERALCO* filed a claim for the recovery of such excess income taxes paid. After examination of the books of *MERALCO* for the covered periods, the *BIR* determined that *MERALCO* had in fact overpaid income taxes in the amount of ₱6,690 million. However, the *BIR* also maintained that *MERALCO* is entitled to a refund amount of only ₱894 million, which pertains to taxable year 2001, claiming that the period for filing a claim had prescribed in respect to the difference between *MERALCO*'s overpayment and the refund amount *MERALCO* is entitled to.

The *BIR* then approved the refund of ₱894 million for issuance of tax credit certificates ("*TCC*s"), proportionate to the actual refund of claims to utility customers. The *BIR* initially issued *TCC*s amounting to ₱317 million corresponding to actual refund to customers as at August 31, 2005. In May 2014, the *BIR* issued additional *TCC*s amounting to ₱396 million corresponding to actual refund to customers as at December 31, 2012.

As at June 30, 2018 and December 31, 2017, the amount of unissued *TCC*s amounting to ₱181 million, is presented as part of "Other noncurrent assets" account in the consolidated statements of financial position.

See *Note 10 – Other Noncurrent Assets.*

MERALCO filed a Petition with the Court of Tax Appeals ("*CTA*") assailing the denial by the *BIR* of its income tax refund claim of ₱5,796 million for the years 1994 - 1998 and 2000, arising from the *SC* decision (net of ₱894 million as approved by the *BIR* for taxable year 2001 "Overpayment of Income Tax related to *SC* Refund"). In a Decision dated December 6, 2010, the *CTA*'s Second Division granted *MERALCO*'s claim and ordered the *BIR* to refund or to issue *TCC* in favor of *MERALCO* in the amount of ₱5,796 million in proportion to the tax withheld on the total amount that has been actually given or credited to its customers.

On appeal by the *BIR* to the *CTA* En Banc, *MERALCO*'s petition was dismissed on the ground of prescription in the Decision of the *CTA* En Banc dated May 8, 2012. On a *MR* by *MERALCO* of the said dismissal, the *CTA* En Banc partly granted *MERALCO*'s motion and issued an Amended Decision dated November 13, 2012, ruling that *MERALCO*'s claim was not yet barred by prescription and remanding the case back to the *CTA* Second Division for further reception of evidence.

The *BIR* filed a *MR* of the above Amended Decision, while *MERALCO* filed its Motion for Partial Reconsideration or Clarification of Amended Decision. Both parties filed their respective Comments to the said motions, and these were submitted for resolution at the *CTA* En Banc.

In a Resolution promulgated on May 22, 2013, the *CTA* denied the said motions of the *BIR* and *MERALCO*, and the *CTA* Second Division was ordered to receive evidence and rebuttal evidence relating to *MERALCO*'s level of refund to customers, pertaining to the excess charges it made in taxable years 1994-1998 and 2000, but corresponding to the amount of ₱5,796 million, as already determined by the said court.

On July 12, 2013, the *BIR* appealed the *CTA* En Banc's Amended Decision dated November 13, 2012 and Resolution dated May 22, 2013 via Petition for Review with the *SC*. As at July 30, 2018, the case is pending resolution by the *SC*.

LFT Assessments of Municipalities

Certain municipalities have served assessment notices on *MERALCO* for *LFT*. As provided in the Local Government Code ("*LGC*"), only cities and provincial governments may impose taxes on establishments doing business in their localities. On the basis of the foregoing, *MERALCO* and its legal counsel believe that *MERALCO* is not subject or liable for such assessments.

RPT Assessments

Several Local Government Units ("*LGU*s") assessed *MERALCO* for deficiency *RPT* on certain assets. The assets include electric transformers, distribution wires, insulators, and poles, collectively referred to as *TWIP*. Of these *LGU*s, one (1) has secured a favorable decision from the *CA*. Such decision was appealed by *MERALCO* to the *SC* for the benefit of *MERALCO* customers. On October 22, 2015, *MERALCO* received a copy of the *SC* Decision promulgated on August 5, 2015 declaring, among others, that the transformers, electric posts, transmission lines, insulators, and electric meters of *MERALCO* are not exempted from *RPT* under the *LGC*. *MERALCO* did not appeal the *SC* Decision. The cases of the other *LGU*s are pending with their respective administrative bodies or government offices.

In 2016, *MERALCO* began the process of settlement with the affected *LGU*s. *MERALCO* has filed for the recovery of the resulting *RPT* payments to certain *LGU*'s from customers in the relevant areas with the *ERC* and will file for similar recovery for succeeding payments.

On January 30, 2017, *PEPOA* filed a Petition for rule-making proposing that *RPT* be allowed as a pass-through cost in the light of the *SC* Decision. Hearings have been completed and *MERALCO* filed its intervention and submitted its comments. As at July 30, 2018, the Petition is pending before the *ERC*.

See Note 18 – Provisions.

Mediation with NPC

The *NPC* embarked on a Power Development Program ("*PDP*"), which consisted of contracting generating capacities and the construction of its own, as well as private sector, generating plants, following a crippling power supply crisis. To address the concerns of the creditors of *NPC*, namely, Asian Development Bank and the World Bank, the Department of Energy ("*DOE*") required that *MERALCO* enter into a long-term supply contract with the *NPC*.

Accordingly, on November 21, 1994, *MERALCO* entered into a 10-year Contract for Sale of Electricity ("*CSE*") with *NPC* which commenced on January 1, 1995. The *CSE* and the rates and amounts charged to *MERALCO* therein, were approved by the *BOD* of *NPC* and the then Energy Regulatory Board, respectively.

Separately, the *DOE* further asked *MERALCO* to provide a market for half of the output of the Camago-Malampaya gas field to enable its development and production of natural gas, which was to generate significant revenues for the Philippine Government and equally significant foreign exchange savings for the country to the extent of the fuel imports, which the domestic volume of natural gas will displace.

MERALCO's actual purchases from *NPC* exceeded the contract level in the first seven (7) years of the *CSE*. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

While the events were beyond the control of *MERALCO*, *NPC* did not honor *MERALCO*'s good faith notification of its off-take volumes. A dispute ensued and both parties agreed to enter into mediation.

The mediation resulted in the signing of a Settlement Agreement ("*SA*") between the parties on July 15, 2003. The *SA* was approved by the respective *BOD*s of *NPC* and *MERALCO*. The net settlement amount of ₱14,320 million was agreed upon by *NPC* and *MERALCO* and manifested before the *ERC* through a Joint Compliance dated January 19, 2006. The implementation of the *SA* is subject to the approval of the *ERC*.

Subsequently, the *OSG* filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between *NPC* and *MERALCO*". As a result, *MERALCO* sought judicial clarification with the *RTC-Pasig*. Pre-trials were set, which *MERALCO* complied with and attended. However, the *OSG* refused to participate in the pre-trial and opted to seek a Temporary Restraining Order ("*TRO*") from the *CA*.

In a Resolution dated December 1, 2010, the *CA* issued a *TRO* against the *RTC-Pasig*, *MERALCO* and *NPC* restraining the respondents from further proceeding with the case. Subsequently, in a Resolution dated February 3, 2011, the *CA* issued a writ of preliminary injunction enjoining the *RTC-Pasig* from conducting further proceedings pending resolution of the Petition. In a Decision dated October 14, 2011, the *CA* resolved to deny the Petition filed by the *OSG* and lifted the injunction previously issued. The said Decision likewise held that the *RTC-Pasig* committed no error in finding the *OSG* in default due to its failure to participate in the proceedings. The *RTC-Pasig* was thus ordered to proceed to hear the case *ex-parte*, as against the *OSG*, and with dispatch. The *OSG* filed a

MR which was denied by the *CA* in its Resolution dated April 25, 2012. The *OSG* filed a Petition for Review on Certiorari with the *SC*. *MERALCO*'s Comment was filed on October 29, 2012. Subsequently, a Decision dated December 11, 2013 was rendered by the First Division of the *SC* denying the Petition for Review on Certiorari by the *OSG* and affirming the Decision promulgated by the *CA* on October 14, 2011.

With the dismissal of the petition filed by the *OSG* with the *CA*, *MERALCO* filed a motion for the reception of its evidence *ex-parte* with the *RTC-Pasig* pursuant to the ruling of the *CA*. In a Decision dated May 29, 2012, the *RTC-Pasig* declared the *SA* valid and binding, independent of the pass-through for the settlement amount which is reserved for the *ERC*. The *OSG* has filed a Notice of Appeal with the *RTC-Pasig* on June 19, 2012. After both parties filed their respective appeal briefs, the *CA* rendered a Decision dated April 15, 2014 denying the appeal and affirming the *RTC* Decision, which declared the *SA* as valid and binding. The *OSG* filed a Petition for Review with the *SC*. On November 10, 2014, *MERALCO* filed its comment to the Petition. *PSALM* likewise filed its comment to the Petition. In a Resolution dated July 8, 2015, the *SC* resolved to serve anew its Resolutions requiring *NPC* to comment on the Petition. In compliance, *NPC* submitted its Comment dated September 8, 2015. *MERALCO* submitted its Motion for Leave to File and to Admit Attached Reply on October 12, 2015. Pursuant to the *SC* Resolution dated November 11, 2015, the *OSG* filed a Consolidated Reply to the comments filed by *NPC*, *MERALCO* and *PSALM*. *MERALCO* then filed a Motion for Leave to File and to Admit the Attached Rejoinder. The parties have filed their respective memoranda. As at July 30, 2018, *MERALCO* is awaiting further action of the *SC* on the matter.

Sucat-Araneta-Balintawak Transmission Line

The Sucat-Araneta-Balintawak transmission line is a two-part transmission line, which completed the 230 *kV* line loop within Metro Manila. The two main parts are the Araneta to Balintawak leg and the Sucat to Araneta leg, which cuts through Dasmariñas Village, Makati City.

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City "the *Plaintiffs*", filed a case against *NPC* with the *RTC-Makati*, enjoining *NPC* from further installing high voltage cables near the *Plaintiffs*' homes and from energizing and transmitting high voltage electric current through said cables because of the alleged health risks and danger posed by the same through the electromagnetic field emitted by said lines. Following its initial status quo Order issued on March 13, 2000, *RTC-Makati* granted on April 3, 2000 the preliminary injunction sought by the *Plaintiffs*. The decision was affirmed by the *SC* on March 23, 2006, which effectively reversed the decision of the *CA* to the contrary. The *RTC-Makati* subsequently issued a writ of execution based on the Order of the *SC*. *MERALCO*, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230 *kV* line will result in widespread and rotating brownouts within *MERALCO*'s franchise area with certain power plants unable to run at their full capacities.

On September 8, 2009, the *RTC-Makati* granted the motions for intervention filed by intervenors *MERALCO* and *NGCP* and dissolved the Writ of Preliminary Injunction issued, upon the posting of the respective counter bonds by defendant *NPC*, intervenors *MERALCO* and *NGCP*, subject to the condition that *NPC* and intervenors will pay for all damages, which the *Plaintiffs* may incur as a result of the Writ of Preliminary Injunction.

In its Order dated February 5, 2013, the *RTC-Makati* granted the *Plaintiffs*' motion and directed the re-raffle of the case to another branch after the judicial dispute resolution failed.

This case remains pending and is still at the pre-trial stage. During the pre-trial stage, *Plaintiffs* filed a Manifestation stating that they are pursuing the deposition of a supposed expert in electromagnetic field through oral examination without leave of court in late January or early February 2016 or on such date as all the parties may agree amongst themselves at the Consulate Office of the Philippines in Vancouver, Canada. *NPC* and intervenors filed their Opposition and Counter-Manifestation. Intervenor *NGCP* filed a Motion to Prohibit the Taking of the Deposition of the said expert. Intervenor *MERALCO* intends to file its Comment/Opposition in due course. As at July 30, 2018, *MERALCO* is awaiting further action of the *SC* on the matter.

Petition for Dispute Resolution against *PEMC*, *TransCo*, *NPC* and *PSALM*

On September 9, 2008, *MERALCO* filed a Petition for Dispute Resolution, against *PEMC*, *TransCo*, *NPC* and *PSALM* with the *ERC* as a result of the congestion in the transmission system of *TransCo* arising from the outages of the San Jose-Tayabas 500 *kV* Line 2 on June 22, 2008, and the 500 *kV* 600 Mega Volt-Ampere Transformer Bank No. 2 of *TransCo*'s San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct *PEMC* to adopt the *NPC*- Time-of-Use ("*TOU*") rate or the new price determined through the price substitution methodology of *PEMC* as approved by the *ERC*, as basis for its billing during the period of the congestion and direct *NPC* and *PSALM* to refund the transmission line loss components of the line rentals associated with *NPC/PSALM* bilateral transactions from the start of *WESM* operation on June 26, 2006.

In a Decision dated March 10, 2010, the *ERC* granted *MERALCO*'s petition and ruled that there is double charging of the transmission line costs billed to *MERALCO* by *NPC* for the Transition Supply Contract ("*TSC*") quantities to the extent of 2.98% loss factor, since the effectivity of the *TSC* in November 2006. Thus, *NPC* was directed to refund line rental adjustment to *MERALCO*. In the meantime, the *ERC* issued an Order on May 4, 2011 allowing *PEMC* to submit an alternative methodology for the segregation of line rental into congestion cost and line losses from the start of the *WESM*. *PEMC* has filed its compliance submitting its alternative methodology.

On September 8, 2011, *MERALCO* received a copy of *PEMC*'s compliance to the *ERC*'s directive and on November 11, 2011, *MERALCO* filed a counter-proposal which effectively simplifies *PEMC*'s proposal.

In an Order of the *ERC* dated June 21, 2012, *MERALCO* was directed to submit its computation of the amount of the double charging of line loss on a per month basis from June 26, 2006 up to June 2012. On July 4, 2012, *MERALCO* filed its Compliance to the said Order. Thereafter, the *ERC* issued an Order directing the parties to comment on *MERALCO*'s submissions. Hearings were conducted on October 2, 2012 and October 16, 2012 to discuss the parties' proposal and comments.

In an Order dated March 4, 2013, the *ERC* approved the methodology proposed by *MERALCO* and *PEMC* in computing the double charged amount on line losses by deducting 2.98% from the *NPC-TOU* amount. Accordingly, the *ERC* determined that the computed double charge amount to be collected from *NPC* is ₱5.2 billion, covering the period November 2006 to August 2012 until actual cessation of the collection of the 2.98% line loss charge in the *NPC-TOU* rates imposed on *MERALCO*. In this regard, *NPC* was directed by the *ERC* to refund said amount by remitting to *MERALCO* the equivalent amount of ₱73.9 million per month until the over-recoveries are fully refunded. In the said Order, the *ERC* likewise determined that the amount to be collected from the successor generating companies ("*SGC*s") is ₱4.7 billion. Additionally, *MERALCO* was directed to file a petition against the following *SGC*s: *MPPCL,* Aboitiz Power Renewables, Inc. ("*APRI*"), *TLI*, *SMEC* and *Sem-Calaca*, within 30 days from receipt thereof, to recover the line loss collected by them. On April 19, 2013, *MERALCO* filed a Motion for Clarification with the *ERC* regarding the directives contained in the March 4, 2013 Order. On April 30, 2013 and May 8, 2013, *PSALM* and

NPC, respectively, filed motions seeking reconsideration of the March 4, 2013 Order. *MERALCO* filed a motion seeking for an additional 15 days from its receipt of the *ERC*'s Order resolving its Motion for Clarification, within which to file its Petition against the *SGC*s.

In an Order dated July 1, 2013, the *ERC* issued the following clarifications/resolutions: (i) *SPPC* should be included as one of the *SGC*s against whom a petition for dispute resolution should be filed by *MERALCO*; (ii) Amount to be refunded by *NPC* is not only ₱5.2 billion but also the subsequent payments it received from *MERALCO* beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates; (iii) Petition to be filed by *MERALCO* against the *SGC*s should not only be for the recovery of the amount of ₱4.7 billion but also the subsequent payments beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates; (iv) "SCPC Ilijan" pertains to *SPPC* instead. Thus, the refundable amount of ₱706 million pertaining to "SCPC Ilijan" should be added to *SPPC*'s refundable amount of ₱1.1 billion; (v) Grant the Motion for Extension filed by *MERALCO* within which to file a petition against the following *SGC*s: *MPPCL*, *APRI*, *TLI*, *SMEC*, *Sem-Calaca* and *SPPC*; and (vi) deny the respective *MR*s filed by *NPC* and *PSALM*.

On September 12, 2013, *MERALCO* filed a Manifestation with Motion with the *ERC* seeking approval of its proposal to offset the amount of ₱73.9 million per month against its monthly remittances to *PSALM*. *PSALM* and *NPC* filed their comments *Ad Cautelam* and Comment and Opposition *Ad Cautelam*, respectively, on *MERALCO*'s Manifestation and Motion. On November 4, 2013, *MERALCO* filed its reply. As at July 30, 2018, *MERALCO*'s Manifestation and Motion is pending resolution by the *ERC*.

On October 24, 2013, *MERALCO* received *PSALM*'s Petition for Review on Certiorari with the *CA* (With Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction Applications) questioning the March 4, 2013 and July 1, 2013 Orders of the *ERC*.

On February 3, 2014, *MERALCO* filed a Comment with Opposition to the Application for *TRO* or Writ of Preliminary Injunction dated January 30, 2014. *PEMC* filed a Comment and Opposition Re: Petition for Certiorari with Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction dated January 6, 2014. On June 4, 2014, the *CA* issued a Resolution declaring that *PSALM* is deemed to have waived the filing of a Reply to the comment and opposition of *MERALCO* and *PEMC* and directing the parties to submit their simultaneous memoranda within 15 days from notice. On December 1, 2014, the *CA* issued a decision dismissing the Petition for Certiorari filed by *PSALM* against the *ERC*, *MERALCO* and *PEMC* and affirming the *ERC*'s ruling on the refund of the ₱5.2 billion of transmission line losses double charged by *PSALM* and *NPC*. On January 30, 2015, *PSALM* filed its *MR* on the December 1, 2014 Decision of the *CA*. *MERALCO* has filed its Opposition to the *MR*. In a Resolution dated August 11, 2015, the *CA* denied *PSALM'*s *MR*. On October 27, 2015, *MERALCO* received *PSALM'*s Petition for Review with the *SC*. The Petition has been given due course and the parties have filed their respective memoranda. As at July 30, 2018, *MERALCO* is still awaiting further action of the *SC* on the Petition.

Petition for Dispute Resolution against SPPC, MPPCL, APRI, TLI, SMEC and Sem-Calaca

On August 29, 2013, *MERALCO* filed a Petition for Dispute Resolution against *SPPC*, *MPPCL*, *APRI*, *TLI*, *SMEC* and *Sem-Calaca.* Said Petition seeks the following: 1) refund of the 2.98% transmission line losses in the amount of ₱5.4 billion, inclusive of the ₱758 million line loss for the period September 2012 to June 25, 2013, from said *SGC*s; and 2) approval of *MERALCO*'s proposal to correspondingly refund to its customers the aforementioned line loss amounts, as and when the same are received from the *SGC*s, until such time that the said over-recoveries are fully refunded, by way of automatic deduction of the amount of refund from the computed monthly generation rate. On

September 20, 2013, *MERALCO* received the *SGC*s' Joint Motion to Dismiss. On October 7, 2013, *MERALCO* filed its Comment on the said Joint Motion.

On October 8, 2013, *MERALCO* received the *SGC*s Manifestation and Motion, which sought, among other things, the cancellation of the scheduled initial hearing of the case, including the submission of the parties respective Pre-trial Briefs, until the final resolution of the *SGC*'s Joint Motion to Dismiss. On October 11, 2013, *MERALCO* filed its pre-trial brief. On October 14, 2013, *MERALCO* filed its Opposition to the *SGC*'s Manifestation and Motion. On October 24, 2013, *MERALCO* received the *SGC'*s Reply to its Comment on the Joint Motion to Dismiss. On October 29, 2013, *MERALCO* filed its Rejoinder. Thereafter, the *SGC*'s filed their Sur-Rejoinder dated November 4, 2013. As at July 30, 2018, the Joint Motion to Dismiss is pending resolution by the *ERC*.

PSALM versus PEMC and MERALCO

Due to the significant increases in *WESM* prices during the 3rd and 4th months of the *WESM* operations, *MERALCO* raised its concerns with the *PEMC* with request for the latter to investigate whether *WESM* rules were breached or if anti-competitive behavior had occurred.

While resolutions were initially issued by the *PEMC* directing adjustments of *WESM* settlement amounts, a series of exchanges and appeals with the *ERC* ensued. *ERC* released an order directing that the *WESM* settlement price for the 3rd and 4th billing months be set at *NPC-TOU* rates, prompting *PSALM* to file a Motion for Partial Reconsideration, which was denied by the *ERC* in an Order dated October 20, 2008. *PSALM* filed a Petition for Review before the *CA*, which was dismissed on August 28, 2009, prompting *PSALM* to file an *MR*, which was likewise denied by the *CA* on November 6, 2009. In December 2009, *PSALM* filed a Petition for Review on Certiorari with the *SC*. *MERALCO* has filed its comments on the Petition and its Memorandum. As at July 30, 2018, *PSALM*'s Petition for Review is pending resolution by the *SC*.

Petition for Dispute Resolution with NPC on Premium Charges

On June 2, 2009, *MERALCO* filed a Petition for Dispute Resolution against *NPC* and *PSALM* with respect to *NPC*'s imposition of premium charges for the alleged excess energy it supplied to *MERALCO* covering the billing periods May 2005 to June 2006. The premium charges amounting to ₱315 million during the May-June 2005 billing periods have been paid but are the subject of a protest by *MERALCO*, and premium charges of ₱318 million during the November 2005, February 2006 and April to June 2006 billing periods are being disputed and withheld by *MERALCO*. *MERALCO* believes that there is no basis for the imposition of the premium charges. The hearings on this case have been completed. As at July 30, 2018, the Petition is pending resolution by the *ERC*.

SC TRO on MERALCO's December 2013 Billing Rate Increase

On December 9, 2013, the *ERC* gave clearance to the request of *MERALCO* to implement a staggered collection over three (3) months covering the December 2013 billing month for the increase in generation charge and other bill components such as *VAT*, *LFT*, transmission charge, and *SL* charge. The generation costs for the November 2013 supply month increased significantly because of the aberrant spike in the *WESM* charges on account of the non-compliance with *WESM* Rules by certain plants resulting in significant power generation capacities not being offered and dispatched, and the scheduled and extended shutdowns, and the forced outages, of several base load power plants, and the use of the more expensive liquid fuel or bio-diesel by the natural gas-fired power plants that were affected by the Malampaya Gas Field, shutdown from November 11 to December 10, 2013.

On December 19, 2013, several party-list representatives of the House of Representatives filed a Petition against *MERALCO*, *ERC* and *DOE* before the *SC*, questioning the *ERC* clearance granted to *MERALCO* to charge the resulting price increase, alleging the lack of hearing and due process. It also sought for the declaration of the unconstitutionality of the *EPIRA*, which essentially declared the generation and supply sectors competitive and open, and not considered public utilities. A similar petition was filed by a consumer group and several private homeowners associations challenging also the legality of the *AGRA* that the *ERC* had promulgated. Both petitions prayed for the issuance of *TRO*, and a Writ of Preliminary Injunction.

On December 23, 2013, the *SC* consolidated the two (2) Petitions and granted the application for *TRO* effective immediately and for a period of 60 days, which effectively enjoined the *ERC* and *MERALCO* from implementing the price increase. The *SC* also ordered *MERALCO*, *ERC* and *DOE* to file their respective comments to the Petitions. Oral Arguments were conducted on January 21, 2014, February 4, 2014 and February 11, 2014. Thereafter, the *SC* ordered all the Parties to the consolidated Petitions to file their respective Memorandum on or before February 26, 2014 after which the Petitions will be deemed submitted for resolution of the *SC*. *MERALCO* complied with said directive and filed its Memorandum on said date.

On February 18, 2014, acting on the motion filed by the Petitioners, the *SC* extended for another 60 days or until April 22, 2014, the *TRO* that it originally issued against *MERALCO* and *ERC* last December 23, 2013. The *TRO* was also similarly applied to the generating companies, specifically *MPPCL*, *SMEC*, *SPPC*, *FGPC*, and the *NGCP*, and the *PEMC* (the administrator of *WESM* and market operator) who were all enjoined from collecting from *MERALCO* the deferred amounts representing the ₱4.15 per *kWh* price increase for the November 2013 supply month.

In the meantime, on January 30, 2014, *MERALCO* filed an Omnibus Motion with Manifestation with the *ERC* for the latter to direct *PEMC* to conduct a re-run or re-calculation of the *WESM* prices for the supply months of November to December 2013. Subsequently, on February 17, 2014, *MERALCO* filed with the *ERC* an Application for the recovery of deferred generation costs for the December 2013 supply month praying that it be allowed to recover the same over a six (6)-month period.

On March 3, 2014, the *ERC* issued an Order voiding the Luzon *WESM* prices during the November and December 2013 supply months on the basis of the preliminary findings of its Investigating Unit ("*IU*") that these are not reasonable, rational and competitive, and imposing the use of regulated rates for the said period. *PEMC* was given seven (7) days upon receipt of the Order to calculate these regulated prices and implement the same in the revised *WESM* bills of the concerned *DU*s in Luzon. *PEMC*'s recalculated power bills for the supply month of December 2013 resulted in a net reduction of the December 2013 supply month bill of the *WESM* by ₱9.3 billion. Due to the pendency of the *TRO*, no adjustment was made to the *WESM* bill of *MERALCO* for the November 2013 supply month. The timing of amounts to be credited to *MERALCO* is dependent on the reimbursement of *PEMC* from associated generator companies. However, several generating companies, including *MPPCL*, SN Aboitiz Power, Inc., Team Energy, PanAsia Energy, Inc. ("*PanAsia*"), and *SMEC*, have filed *MR*s questioning the Order dated March 3, 2014. *MERALCO* has filed a consolidated comment to these *MR*s. In an Order dated October 15, 2014, the *ERC* denied the *MR*s. The generating companies have appealed the Orders with the *CA*. *MERALCO* has filed a motion to intervene and a comment in intervention. The *CA* consolidated the cases filed by the generation companies. In a Decision dated November 7, 2017, the *CA* set aside *ERC* Orders dated March 3, 2014, March 27, 2014, May 9, 2014 and October 15, 2014 and declared the orders null and void. The Decision then reinstated and declared valid *WESM* prices for the November and December 2013 supply months. *MERALCO* and the *ERC* have filed their respective motions for reconsideration. Several consumers also intervened in

the case and filed their respective motions for reconsideration. The *CA* has yet to resolve the motions for reconsideration filed by *MERALCO* and *ERC*.

In view of the pendency of the various submissions before the *ERC* and mindful of the complexities in the implementation of the *ERC*'s Order dated March 3, 2014, the *ERC* directed *PEMC* to provide the market participants an additional period of 45 days to comply with the settlement of their respective adjusted *WESM* bills. In an Order dated May 9, 2014, the parties were then given an additional non-extendible period of 30 days from receipt of the Order within which to settle their *WESM* bills. However, in an Order dated June 6, 2014 and acting on an intervention filed by Angeles Electric Corporation, the *ERC* deemed it appropriate to hold in abeyance the settlement of *PEMC*'s adjusted *WESM* bills by the market participants.

On April 22, 2014, the *SC* extended indefinitely the *TRO* issued on December 23, 2013 and February 18, 2014 and directed generating companies, *NGCP* and *PEMC* not to collect from *MERALCO*. As at July 30, 2018, the *SC* has yet to resolve the various petitions filed against *MERALCO*, *ERC*, and *DOE*.

ERC IU Complaint

On December 26, 2013, the *ERC* constituted the *IU* under its Competition Rules to investigate possible anti-competitive behavior by the industry players and possible collusion that transpired in the *WESM* during the supply months of November 2013 and December 2013. *MERALCO* participated in the proceedings and submitted a Memorandum.

An investigating officer of the *IU* filed a Complaint dated May 9, 2015 against *MERALCO* and *TMO* for alleged anti-competitive behavior constituting economic withholding in violation of Section 45 of the *EPIRA* and Rule 11, Section 1 and 8(e) of the *EPIRA IRR*. In an Order dated June 15, 2015 the *ERC* directed *MERALCO* to file its comment on the Complaint. *MERALCO* and *TMO* have filed their respective answers to the Complaint.

In an Order dated September 1, 2015, the *ERC* directed the investigating officer to file his reply to *MERALCO*. In a Manifestation and Motion to Set the Case for Hearing dated November 9, 2015, the investigating officer manifested that he would no longer file a reply and that the case be set for hearing.

On May 24, 2016, the *ERC* promulgated Resolution No. 14, Series of 2016, which resolved to divide the Commission into two (2) core groups for the conduct of hearings and to designate the commissioners to act as presiding officers in anti-competition cases. The raffle pursuant to said Resolution was conducted on June 15, 2016.

In a Notice of Pre-Trial Conference dated June 16, 2016, the *ERC* set the pre-trial conference on August 18, 2016 and required *MERALCO* and *TMO* to submit their respective pre-trial briefs. However, on July 27, 2016, the complainant filed two (2) omnibus motions for the consolidation and deferment of the pre-trial conferences. Hence, in an Order dated August 1, 2016, the respondents were given 10 days to submit their comments on the Motion for Consolidation, with the complainant given five (5) days to file his reply. As such, the pre-trial conferences as scheduled were deferred until further notice and all parties were granted 20 days to submit their respective pre-trial briefs.

In the meantime, *MERALCO* likewise filed an Urgent Motion to Dismiss with Motion to Suspend Proceedings which was adopted by *TMO* in its Manifestation and Motion filed on July 28, 2016. *MERALCO* maintained that the Complaint should be dismissed due to the absence of subject matter jurisdiction as it is now the Philippine Competition Commission ("*PCC*") which has original and

primary jurisdiction over competition-related cases in the energy sector. On August 23, 2016, *MERALCO* filed an Urgent Motion Ad Cautelam for suspension of proceeding including period to file pre-trial brief and judicial affidavit.

In a Motion dated August 25, 2016, complainant filed a Motion to defer the submission of the complainant's pre-trial brief and judicial affidavit. In an Order dated June 13, 2017, the *ERC* denied the motion to consolidate but upheld the authority of private counsel to represent the complainants. *MERALCO* filed a Motion for Partial Reconsideration to question such authority.

In an Order dated February 2, 2017, the *ERC* denied the motion to dismiss and asserted jurisdiction over the Complaint. *MERALCO* filed its *MR* to the Order on February 23, 2017. In an Order dated June 20, 2017, the *ERC* denied the *MR*. On September 19, 2017, *MERALCO* filed a Petition for Certiorari with the *CA*. In a Resolution dated October 2, 2017, the *CA* required respondents to file their Comment on the Petition within 10 days and held in abeyance its resolution on the prayer for injunctive relief until the comments have been filed. *MERALCO* was likewise given five (5) days to file its reply. In a Manifestation dated October 23, 2017, the *ERC* stated that it is a nominal party in the case as the quasi-judicial tribune that issued the assailed ordinances. The *IU* filed its own Comment dated December 19, 2017. In a Manifestation and Motion dated December 22, 2017, the *OSG* informed the *CA* that it will no longer represent the *IU* and will instead participate as "tribune of the people". In the meantime, *TMO* also filed a separate Petition for Review on Certiorari with the *CA*. In a Resolution dated January 10, 2018, the *CA* ordered the consolidation of the petitions of *TMO* and *MERALCO*. In a Decision dated May 23, 2018, the *CA* denied the consolidated Petitions filed by *MERALCO*, *TMO*, and *APRI*, and ruled that the jurisdiction to resolve the *IU* cases remains with the *ERC* because the Philippine Competition Act ("*PCA*") does not apply retroactively.

On June 20, 2018, *MERALCO* filed an *MR* with the *CA*. The *ERC* likewise filed its Motion for Partial Reconsideration on the ground that it retained concurrent jurisdiction together with the *PCC* over cases involving alleged anti-competitive conduct supposedly because the *PCA* did not repeal Section 45 of the *EPIRA*. In a Resolution dated July 3, 2018, *MERALCO* was directed to file its comment to the *ERC*'s Motion for Partial Reconsideration. *MERALCO* is currently preparing its Comment to the Motion for Partial Reconsideration of the *ERC*.

SPPC vs. PSALM

SPPC and *PSALM* are parties to an Independent Power Producer Administration ("*IPPA*") Agreement covering the Ilijan Power Plant. On the other hand, *MERALCO* and *SPPC* have a *PSA* covering the sale of electricity from the Ilijan Power Plant to *MERALCO*. In a letter dated September 8, 2015, *SPPC* informed *MERALCO* that due to an ongoing dispute with *PSALM* arising from difference in interpretation of the provisions of the *IPPA* Agreement, the latter terminated the said Agreement. *SPPC* filed a complaint at the *RTC*-Mandaluyong to nullify the termination notice for lack of factual and legal basis. On said date, the executive judge of *RTC*-Mandaluyong issued a 72-hour *TRO*. In an Order dated September 11, 2015, the *RTC*-Mandaluyong extended the *TRO* by an additional 17 days. In an Order dated September 28, 2015, the *RTC*-Mandaluyong granted the prayer for preliminary injunction. *PSALM* has filed *MR*s to question the Orders.

MERALCO filed a Motion for Leave to Intervene with Motion to Admit Attached Complaint-in-Intervention. In an Order dated October 19, 2015, the *RTC*-Mandaluyong allowed *MERALCO*'s intervention in the proceedings and admitted its Complaint-in-Intervention. *PSALM* filed a *MR* dated November 6, 2015 of the Order admitting *MERALCO*'s intervention. *RTC*-Mandaluyong issued an Order dated June 27, 2016 denying the *MR*s. *PSALM* has elevated these orders to the *CA* through a Petition for Certiorari. In a Resolution dated May 25, 2017, the *CA* denied *PSALM*'s prayer for the issuance of a *TRO* and/or writ of preliminary injunction. In a Decision dated December 19, 2017, the

CA dismissed the Petition and affirmed the Orders of the *RTC*-Mandaluyong. As at July 30, 2018, hearings are ongoing before the new presiding judge.

Ombudsman Cases Against Directors

On January 30, 2018, *MERALCO* received an Order dated January 22, 2018 from the Office of the Ombudsman directing *MERALCO*'s directors to comment on a complaint-affidavit for syndicated estafa filed by a consumer group which charged that there was conspiracy between *MERALCO* directors and the *ERC* regarding the alleged misappropriation of the bill deposits received from *MERALCO* consumers. On February 9, 2018, *MERALCO*'s directors filed their Counter-Affidavits where they refuted the arguments of the consumer group. In a Resolution dated May 18, 2018, the criminal complaint for syndicated estafa was dismissed for insufficiency of evidence. The case was referred to the *COA* for the conduct of audit on the bill deposits collected by *MERALCO* from the public consumers and to inform the Ombudsman of the compliance therewith. The consumer group filed a Motion for Partial Reconsideration dated June 16, 2018 to which *MERALCO* filed its Comment. *MERALCO* is awaiting further action of the Office of Ombudsman on the case.

On February 28, 2018, *MERALCO* received an Order dated February 20, 2018 from the Office of the Ombudsman directing *MERALCO*'s directors to comment on a complaint-affidavit for syndicated estafa filed by certain consumer group which charged that there was conspiracy between *MERALCO* directors and the *ERC* regarding the *MERALCO*'s investment activities in other businesses for being violative of its legislative franchise and the *EPIRA*. On March 12, 2018, *MERALCO*'s directors filed their Counter-Affidavits where they refuted the arguments of the consumer group. As at July 30, 2018, *MERALCO* is awaiting further action of the Office of the Ombusdman on the matter.

Others

Liabilities for certain local taxes amounting to ₱2,802 million and ₱2,810 million as at June 30, 2018 and December 31, 2017, respectively, are included in the "Other noncurrent liabilities" account in the consolidated company statements of financial position.

Management and its internal and external counsels believe that the probable resolution of these issues will not materially affect *MERALCO'*s financial position and results of operations.

29. Significant Contracts and Commitments

MERALCO

Contracts for the CSE and *PSAs with Privatized Plants* and *IPPAs*

MERALCO entered into separate *PSAs* with *SPPC*, *Sem-Calaca* and *MPPCL* on December 12, 20 and 21, 2011, respectively. Also, separate *PSAs* with *TLI* and *SMEC* were executed on February 29 and June 26, 2012, respectively. These *PSA*s are for a period of seven (7) years, extendable for three (3) years upon agreement of the parties. Thereafter, applications for approval of the *PSA*s were filed with the *ERC*.

MPower likewise signed separate *PSA*s with *SPPC*, *MPPCL*, *Sem-Calaca*, and *TLI* on December 12, 2011, March 16, 2012, June 25, 2012, October 10, 2012 and October 19, 2012, respectively.

In separate Decisions dated December 17, 2012, the *ERC* approved with modifications the *PSA*s of *MERALCO* with *SPPC*, *Sem-Calaca*, *MPPCL*, *TLI* and *SMEC*.

*MR*s were filed regarding the *ERC* decisions on the *PSA*s with *SPPC*, *Sem-Calaca* and *SMEC*. *MERALCO* is awaiting the decision of the *ERC* on the *SPPC* and *Sem-Calaca MR*s. In an Order dated December 16, 2013, the *ERC* denied the Motion for Partial Reconsideration on the *PSA* with *SMEC*. Both *MERALCO* and *SMEC* have filed separation motions with respect to such order. In an Order dated May 29, 2018, the *ERC* partially granted the Motion for Partial Reconsideration on the *PSA* with *Sem-Calaca*. On July 25, 2018, *MERALCO* filed a motion for clarification of the said Order and the parties are under discussions regarding how to implement the same.

MERALCO entered into separate Supplemental Agreements with *MPPCL* and *TLI* on April 8 and 27, 2016, respectively, for the extension of the term of these *PSA*s for an additional period of three (3) years up to December 25, 2022. Thereafter, relevant Manifestations with Motion for Approval of the Supplemental Agreements were filed with the *ERC*.

Under the *PSA*s approved by the *ERC*, fixed capacity fees and fixed operating maintenance fees are recognized monthly based on their contracted capacities. The annual projection of these payments is shown in the table below:

Year	Contracted Capacity	Fixed Payment Amount
	(In Megawatt)	*(In millions)*
2018	2,425	₱31,663
2019	2,430	28,100
2020	1,035	19,030
2021	525	9,300
2022-2036	525	144,850
2037-2039	455	26,875

On January 1, 2018, the *Tax Reform for Acceleration and Inclusion* ("*TRAIN*") Law became effective. Among other things, the *TRAIN* Law increased the excise tax on coal from ₱10.00 per metric ton to ₱50.00 per metric ton, effective January 1, 2018. This tax is to increase year on year, up to ₱150.00 per metric ton for coal, effective January 1, 2020. Under *MERALCO*'s *PSA* with *TLI,* should there be any increase in existing charges, fees, taxes, duties assessments, or other similar amounts, a party to the *PSA* may claim the same as a charge due to change in law, upon *ERC* approval thereof. On July 19, 2018, *MERALCO* and *TLI* filed a joint application for approval of recovery of the increase in excise tax as a result of the implementation of the *TRAIN* Law.

FGPC and *FGP*

In compliance with the *DOE'*s program to create a market for Camago-Malampaya gas field and enable its development, *MERALCO* has committed to contract 1,500 *MW* of the 2,700 *MW* output of the Malampaya gas field.

Accordingly, *MERALCO* entered into separate 25-year *PPA*s with *FGPC* (March 14, 1995) and *FGP* (July 22, 1999) for a minimum number of *kWh* of the net electrical output of the Sta. Rita and San Lorenzo power plants, respectively, from the start of their commercial operations. The *PPA* with *FGPC* terminates on August 17, 2025, while that of *FGP* ends on October 1, 2027.

On January 7, 2004, *MERALCO*, *FGP* and *FGPC* signed an Amendment to their respective *PPA*s. The negotiations resulted in certain new conditions including the assumption of *FGP* and *FGPC* of community taxes at current tax rate, and subject to certain conditions increasing the discounts on

excess generation, payment of higher penalties for non-performance up to a capped amount, recovery of accumulated deemed delivered energy until 2011 resulting in the non-charging of *MERALCO* of excess generation charge for such energy delivered beyond the contracted amount but within a 90% capacity quota. The amended terms under the respective *PPA*s of *FGP* and *FGPC* were approved by the *ERC* on May 31, 2006.

Under the respective *PPA*s of *FGP* and *FGPC*, the fixed capacity fees and fixed operating and maintenance fees are recognized monthly based on the actual Net Dependable Capacity tested and proven, which is usually conducted on a semi-annual basis.

QPPL

MERALCO entered into a *PPA* with *QPPL* on August 12, 1994, which was subsequently amended on December 1, 1996. Under the terms of the amended *PPA*, *MERALCO* is committed to purchase a specified volume of electric power and energy from *QPPL*, subject to certain terms and conditions. The *PPA* is for a period of 25 years from the start of commercial operations up to July 12, 2025.

In a Letter Agreement signed on February 21, 2008, the amount billable by *QPPL* included a transmission line charge reduction in lieu of a previous rebate program. The Letter Agreement also provides that *MERALCO* make advances to *QPPL* of US$2.85 million per annum for 10 years beginning 2008 to assist *QPPL* in consideration of the difference between the transmission line charge specified in the Transmission Line Agreement ("*TLA*") and the *ERC*-approved transmission line charge in March 2003. *QPPL* shall repay *MERALCO* the same amount at the end of the 10-year period in equal annual payments without adjustment. However, if *MERALCO* is able to dispatch *QPPL* at a plant capacity factor of no less than 86% in any particular year, *MERALCO* shall not be required to pay US$2.85 million on that year. This arrangement did not have any impact on the rates to be charged to consumers and hence, did not require any amendment in the *PPA*, as approved by the *ERC*.

See *Note 10 – Other Noncurrent Assets.*

Committed Energy Volume to be Purchased

The following are forecasted purchases/payments to *FGPC*, *FGP* and *QPPL* corresponding to the Minimum Energy Quantity ("*MEQ*") provisions of the contracts. The forecasted fixed payments include capacity charge and fixed operation and maintenance cost escalated using the U.S. and Philippine Consumer Price Index.

Year	MEQ	Equivalent Amount
	(In million kwh)	*(In Millions)*
2018	14,717	₱23,502
2019	14,898	23,495
2020	14,898	24,040
2021 to 2025	74,488	118,938
2026 to 2027	21,797	37,431

Philippine Power and Development Company ("*Philpodeco*")

On May 15, 2014, *MERALCO* and *Philpodeco* executed a *PSA*. *Philpodeco* operates three (3) run-of-river hydro power plants, namely: (i) Palakpakin, a 448 *kW* hydro power plant located at Barangay Prinza, Calauan, Laguna; (ii) Calibato, a 75 *kW* Calibato hydro power plant located at Barangay Sto. Angel, San Pablo City, Laguna; and (iii) Balugbog, a 528 *kW* hydro power plant located at

Barangay Palina, Nagcarlan, Laguna. The *PSA* has a term of five (5) years from the delivery period commencement date.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for the approval of its *PSA* with *Philpodeco*. This *PSA* provides that *MERALCO* shall accept all the energy deliveries of *Philpodeco* as measured by the latter's billing meter. Hearings on this case have been completed and *MERALCO* has submitted its *FOE*. As at July 30, 2018, the case is pending decision by the *ERC*.

Bacavalley Energy Inc. ("*BEI*")

MERALCO signed a *CSE* with *BEI* on November 12, 2010. *BEI* owns and operates a four (4) *MW* renewable energy generation facility powered by landfill gas in San Pedro, Laguna. The *CSE* has a term of two (2) years from the delivery period commencement date.

Purchases from *BEI*, an embedded renewable energy generator, are *VAT* zero-rated and exempt from power delivery service charge. *MERALCO* filed an application for the approval of the *CSE* with the *ERC*, for the provisional implementation of the contract on December 15, 2010. In an order dated January 31, 2011, the *ERC* provisionally approved the said application.

After a series of negotiations, *MERALCO* and *BEI* signed the Letter Agreements dated March 1, 2013 and March 5, 2013, extending the *CSE* between said parties for another two (2) years from March 16, 2013, or until March 16, 2015. In its Order December 9, 2013, the *ERC* allowed the *CSE* to be extended until March 15, 2015. On March 12, 2015, *MERALCO* and *BEI* executed a Letter of Agreement extending the *CSE* until March 16, 2016. On March 16, 2015, *MERALCO* filed a Manifestation with Motion to the *ERC* for approval of the extended term. On March 1, 2016, *BEI* requested for another extension of the *CSE* for another two (2) years. In its letter dated April 7, 2016, *MERALCO* denied *BEI*'s request to extend the *CSE*. As at July 30, 2018, the contract term has expired and *MERALCO* is awaiting the *ERC*'s decision on its Manifestation with Motion.

Pangea Green Energy Philippines, Inc. ("*PGEP*")

On May 31, 2012, *MERALCO* signed a *CSE* with *PGEP,* a biomass power plant located in Payatas, Quezon City using methane gas extracted from the Payatas Landfill as its fuel. Its plant has a total nominal generating capacity of 1,236 *kW*. The *CSE* is for a period of two (2) years from the delivery period commencement date.

On June 15, 2012, *MERALCO* filed an application for approval of the *CSE*. On August 28, 2012, the *ERC* issued an Order provisionally approving the application. On August 29, 2013, the *ERC* extended the provisional authority in its Order dated August 12, 2013. On March 2, 2015, *MERALCO* and *PGEP* executed a Letter of Agreement extending the *CSE* until February 29, 2016. On March 4, 2015, *MERALCO* filed a Manifestation with Motion with the *ERC* for approval of the extended term. On September 16, 2015, *MERALCO* received a letter from *PGEP* seeking the termination of the *CSE* effective October 15, 2015. The termination of the *CSE* was thereafter formalized in the Letter Agreement dated October 29, 2015 where the parties agreed to terminate the *CSE* effective October 9, 2015, which was *PGEP*'s Facility Registration Date with the *WESM*. On January 8, 2016, *MERALCO* filed a Manifestation with Motion with the *ERC* seeking approval of the extended term of March 4, 2015 until October 9, 2015. As at July 30, 2018, the contract term has expired and the Decision remains pending with the *ERC*.

TMO

On March 4, 2013, *MERALCO* signed an Interconnection Agreement with *TMO* for their 243 *MW* generating facility at the Navotas Fish Port Complex, Navotas City, which is an interconnection at *MERALCO*'s Grace Park-Malabon 115 *kV* line. *TMO* is an embedded generator. *TMO* shall construct at its own cost, operate and maintain the 115 *kV* line connecting its generating facility to *MERALCO*'s system. *TMO* and *MERALCO* subsequently signed a Supplement to the Interconnection Agreement dated July 3, 2014 covering the construction of a second line from the connection point at the Grace Park-Malabon 115 *kV* line to the *TMO* switchyard.

On September 27, 2013, *MERALCO* signed a *PSA* with *TMO* for the output of the barge-mounted, bunker oil-fired diesel engines moored at the Fish port Complex in Navotas, Manila. On September 30, 2013, *MERALCO* filed an application with the *ERC* for the approval of the *PSA*. In an Order dated November 4, 2013, the *ERC* granted the prayer for provisional authority. After hearing and submission of the required documents, including the *FOE*, the case is now submitted for decision.

On December 17, 2014, *MERALCO* and *TMO* entered into an Amendment to the *PSA* based on the power situation outlook for 2015 and 2016 issued by the *NGCP* that the reserve capacity will be below the Contingency Reserves due to the maintenance shutdowns and forced outages of major power plants in Luzon. The amendment to the *PSA* was filed for approval with the *ERC* on January 21, 2015. In an Order dated April 6, 2015, the *ERC* approved the amendment in the *PSA* between *MERALCO* and *TMO* with modification. In an Order dated July 1, 2015, the *ERC* clarified that the provisional approval, while not specifically modifying nor stating any condition with respect to the implementation of the outage provisions of the amendment, covers the increase in outage allowance and the minor change in operating procedures.

On June 16, 2015, *MERALCO* received the Omnibus Motion for Partial Reconsideration and Deferment of Implementation of the Order dated April 6, 2015; Urgent Resolution of the Application; and Confidential Treatment filed by *TMO*.

In an Order dated April 5, 2016, the *ERC* ruled that the provisional authority granted to *MERALCO* and *TMO* is extended unless revoked or made permanent. On June 10, 2016 and July 5, 2016, respectively, *MERALCO* and *TMO* filed a Motion for Clarification of the *ERC* Order dated April 5, 2016. Said motions are still pending decision by the *ERC*. On January 3, 2017, *MERALCO* filed a Manifestation with Motion informing the *ERC* of the extension of the term of the *PSA* from June 26, 2017 to June 25, 2018. In an Order dated June 6, 2017, the *ERC* noted *MERALCO*'s Manifestation and Motion and confirmed the one (1) year extension of the *PSA*. *MERALCO* and *TMO* were further directed to strictly comply with the provisions of *ERC* Resolution No. 1, Series of 2016, in particular, the one (1) time limit for renewal of the *PSA*. In a letter dated June 11, 2018, *MERALCO* wrote to *DOE*, requesting for grant of exemption from conduct of a competitive selection process, as required under *DOE* Circular No. DC2018-02-003, for a *PSA* with *TMO* with term from June 26, 2018 to June 25, 2019. *TMO* sent a similar letter subsequently. Parties still await action of *DOE* on such request. As at July 30, 2018, the contract term has expired and the decision remains pending with the *ERC*.

SBPL

On May 30, 2014, *MERALCO* signed a long-term *PSA* for a 455 *MW* net capacity and electrical output with *SBPL*. *SBPL* will be constructing a supercritical coal-fired power plant in Mauban, Quezon.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for approval of its *PSA* with *SBPL*. On May 19, 2015, *MERALCO* received the *ERC* Decision approving with modification the *PSA* between *MERALCO* and *SBPL*.

Bacman Geothermal, Inc. ("*BGI*")

On November 25, 2014, *MERALCO* signed a *PSA* with *BGI* for the purchase of up to 50 *MW* capacity and energy from the latter's power plant. The *PSA* shall expire on December 25, 2019, extendible by an additional two (2) years upon mutual agreement of the parties. On March 4, 2015, the Joint Application for approval of said *PSA* was filed with the *ERC*. As at July 30, 2018, the case is pending decision by the *ERC*.

RP Energy

On April 20, 2016, *MERALCO* signed a 20-year *PSA* with *RP Energy* for the purchase of 225 *MW* capacity and energy from the first 300 *MW* unit of 2 x 300 *MW* coal-fired power plant that *RP Energy* intends to construct, own, operate, manage and maintain in Subic, Zambales, within the Subic Bay Freeport Zone. On April 29, 2016, the Joint Application for approval of the said *PSA* was filed with the *ERC*. After hearings and filing by *MERALCO* and *RP Energy* of their respective *FOE*, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s which the *ERC* likewise denied in an order dated November 17, 2017. On January 5, 2018, the *ERC* conducted a hearing for the purpose of giving the consumer group a chance to present its evidence. However, due to its unjustified and continued absence, the consumer group was deemed to have waived its right to present its evidence. Thus, the *ERC* deemed the case submitted for decision. However, despite the case having been submitted for decision, the *ERC* hearing officer allowed an oppositor to submit his written comment/opposition to the continuation of the proceedings. On January 15, 2018, a written comment/opposition was filed by oppositor and on January 19, 2018, *MERALCO* filed its opposition to the said comment/opposition. As at July 30, 2018, the case is pending decision by the *ERC*.

A1E

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *A1E* for the purchase of 1,200 *MW* of electrical output from the 2 x 600 *MW* supercritical coal-fired power generating facility that *A1E* intends to construct, own, operate, manage and maintain in Atimonan, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. After completion of the hearings and filing by *MERALCO* and *A1E* of their respective *FOE* on March 8, 2017, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s, which the *ERC* likewise denied in an order dated November 17, 2017. On March 29, 2017, *MERALCO* and *A1E* filed their Joint Urgent Motion to Resolve. On May 22, 2017, *A1E* filed its Manifestation for Urgent Resolution. Thereafter, on May 23, 2017, *MERALCO* and *A1E* both filed separate letters for Urgent Resolution of the case. On October 19, 2017, *MERALCO* filed its Third Urgent Motion to Resolve. Then on November 8, 2017, *MERALCO* received *A1E's* Urgent Motion for Resolution. As at July 30, 2018, the case is pending decision by the *ERC*.

St. Raphael

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *St. Raphael* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *St. Raphael* intends to construct, own, operate, manage and maintain in Calaca, Batangas. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. After hearings and filing by *MERALCO* and *St. Raphael* of their respective *FOE*, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s, which the *ERC* likewise denied in an order dated November 17, 2017. On January 10, 2018, the *ERC* conducted a hearing for the purpose of giving the consumer group a chance to present its evidence. However, due to its unjustified and continued absence, the consumer group was deemed to have waived its right to present its evidence. Thus, the *ERC* deemed the case submitted for decision. Nevertheless, on April 13, 2018, the *ERC* issued an Order directing *MERALCO* and *St. Raphael* to submit additional compliance documents (all to be provided by *St. Raphael*) in order to aid *ERC* in its evaluation of the present case.

Central Luzon Premiere Power Corp. ("*Central Luzon Power*")

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Central Luzon Power* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *Central Luzon Power* intends to construct, own and operate in Pagbilao, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated January 25, 2017, the *ERC* held the processing of the application in abeyance. On March 2, 2017, *MERALCO* received the *MR* of *Central Luzon Power* on of the said *ERC* Order. Meanwhile, several consumers filed their petitions to intervene. On July 25, 2017, *MERALCO* received a copy of a Motion filed by several consumers with the *ERC* on July 14, 2017 seeking the dismissal of the case, to which *MERALCO* filed an Opposition. In an Order dated March 20, 2018, *ERC* directed *MERALCO* and *Cental Luzon Power* to submit a written explanation on the status of the *ECC* application, or in the alternative, should the *ECC* be ready, to submit the same to the *ERC*. *Central Luzon Power* filed a pleading explaining status of the *ECC* application. As at July 30, 2018, further *ERC* action is pending.

Mariveles Power

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Mariveles Power* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *Mariveles Power* intends to construct, own and operate in Mariveles, Bataan. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On September 30, 2016, *Mariveles Power* filed a *MR* of the said *ERC* Order. Meanwhile, several consumers filed their petitions to intervene. On July 25, 2017, *MERALCO* received a copy of a Motion filed by several consumers with the *ERC* on July 14, 2017 seeking the dismissal of the case, to which *MERALCO* filed an Opposition. In an Order dated March 20, 2018, *ERC* directed *MERALCO* and *Mariveles Power* to submit a written explanation on the status of the *ECC* application, or in the alternative, should the *ECC* be ready, to submit the same to the *ERC*. *Mariveles Power* filed a pleading explaining status of the *ECC* application. As at July 30, 2018, further *ERC* action is pending.

PEDC

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *PEDC* for the purchase of up to 70 *MW* of electrical output from the 1 x 150 *MW* coal-fired power generating facility that *PEDC* owns and operates in Brgy. Ingore, La Paz, Iloilo. In its letter dated November 23, 2016, the *ERC* informed *MERALCO* that *ERC* has provisionally approved the *PSA* between *MERALCO* and *PEDC* in its order dated July 11, 2016. On January 10, 2017, *MERALCO* and *PEDC* filed their Joint Motion to Admit the *FOE* with Joint Urgent Motion for Early Resolution of the Application, seeking to, among other things, already source 70 *MW* from *PEDC* beginning January 28, 2017 in order to temper the anticipated additional burden that the *SPEX*-Malampaya outage may bring to end-users. On January 17, 2017, *MERALCO* received a letter dated November 23, 2016, informing *MERALCO* that *ERC* provisionally approved the *PSA*. On March 3, 2017, *PEDC* filed a Motion partially seeking reconsideration of the provisional rate approved under the *PSA*. On October 3, 2017, *PEDC* filed a Supplemental Motion for Reconsideration. On April 30, 2018, *MERALCO* received *PEDC*'s Manifestation and Motion praying that *MERALCO* be authorized by the *ERC* to collect from its customers the difference between the provisional rate approved by the *ERC* and the rates originally applied for under the *PSA*. As at July 30, 2018, further *ERC* action is pending.

Meanwhile, several consumers filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the requests for intervenor status but treating them instead as oppositors. Oppositors filed their respective *MR*s, which the *ERC* likewise denied in an order dated November 17, 2017. On January 15, 2018, the *ERC* conducted a hearing for the purpose of giving intervenor *NASECORE* a chance to present its evidence. However, due to its unjustified and continued absence, *NASECORE* was deemed to have waived its right to present its evidence. Thus, the *ERC* deemed the case submitted for decision. On January 19, 2018, *MERALCO* received a motion filed by an oppositor before the *CA* seeking additional time to file a Petition for Review. On January 26, 2018, *MERALCO* received the Petition for Review. In a decision dated February 28, 2018, the *CA* denied the Petition, prompting the oppositor's filing of an *MR*. As at July 30, 2018, the *CA* has yet to act on the *MR*.

Global Luzon Energy Development Corporation ("*GLEDC*")

On April 27, 2016, *MERALCO* signed a 20-year *PSA* with *GLEDC* for the purchase of 600 *MW* of electrical output from the 2 x 335 *MW* coal-fired power generating facility that *GLEDC* intends to construct, own, operate, manage and maintain in Luna, La Union. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On October 21, 2016, *MERALCO* received *GLEDC*'s *MR* of the said Order. Meanwhile, several consumers filed their petitions to intervene. On July 25, 2017, *MERALCO* received a motion seeking the dismissal of the case, to which *MERALCO* filed an Opposition. On March 6, 2018, *GLEDC* filed a Manifestation updating the *ERC* of the status of its *ECC* Application. In an Order dated March 20, 2018, *ERC* directed *MERALCO* and *GLEDC* to submit a written explanation on the status of the *ECC* application, or in the alternative, should the *ECC* be ready, to submit the same to the *ERC*. *GLEDC* filed a pleading explaining status of the *ECC* application. As at July 30, 2018, the case is still awaiting further action from the *ERC*.

First Bulacan

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *First Bulacan* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan. On February 23, 2017, after conduct of a Competitive Selection Process ("*CSP*") wherein *First Bulacan* was declared as the winning power supplier, the application for approval of the *PSA* with *First Bulacan* was filed. Hearings have been completed and *MERALCO* filed its *FOE* on July 12, 2017. In a letter dated

December 29, 2017, the *ERC* informed *MERALCO* and *First Bulacan* that the *ERC* resolved to grant interim relief for approval of the *PSA*. However, such interim relief is not contemplated under the *PSA* and the parties have yet to implement the *PSA*. *First Bulacan* filed a Motion for Reconsideration and an Urgent Motion to Resolve the Motion for Reconsideration, which sought reconsideration of the Order of interim relief. As at July 30, 2018, both are pending resolution by the *ERC*.

Solar Philippines Tanauan Corporation ("*Solar Philippines Tanauan*")

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tanauan* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas. On February 27, 2017, after conduct of a *CSP* wherein *Solar Philippines Tanauan* was declared as the winning power supplier, the application for approval of the *PSA* with *Solar Philippines Tanauan* was filed. Hearings have been completed and *MERALCO* filed its *FOE* on July 12, 2017. In a letter dated December 29, 2017, *ERC* informed *MERALCO* and *Solar Philippines Tanauan* that the *ERC* resolved to grant an interim relief for approval of the *PSA*. However, such interim relief is not contemplated under the *PSA* and the parties have yet to implement the *PSA*.

Solar Philippines Tarlac Corporation ("*Solar Philippines Tarlac*")

On October 6, 2017, after being declared the winner power supplier in a *CSP*, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tarlac* for the purchase of up to 85 *MW* of electrical output from its solar plant in Tarlac. The application for approval of the *PSA* with *Solar Philippines Tarlac* was filed on October 19, 2017. Hearings have been completed and parties await *ERC* resolution on *Solar Philippines Tarlac*'s opposition to a consumer group's intervention, which shall prompt submission of case for final decision. Meanwhile, in an Order dated February 20, 2018, the *ERC* granted Interim Relief to provisionally implement the *PSA*. On July 3, 2018, *Solar Philippines Tarlac* filed a Motion for Partial Reconsideration of the Order dated February 20, 2018 of the *ERC*. *MERALCO* and *Solar Philippines Tarlac* have on-going discussions to resolve implementation of the Order.

First NatGas Power Corp. ("FNPC")

Following conduct and completion of a *CSP*, *MERALCO* confirmed effectivity of the *PSA* with *FNPC* dated December 13, 2017, for the purchase of electric energy generated by its Plant beginning *ERC* approval and ending on February 23, 2024. A joint application for approval of the *PSA* with *FNPC* was filed on March 19, 2018. In an Order dated June 5, 2018, *ERC* granted Interim Relief to provisionally implement the *PSA*. On June 26, 2018, *MERALCO* and *FNPC* implemented the *PSA* based on the June 5, 2018 Order of the *ERC*. Hearings have commenced and the next one is set on August 6, 2018.

*Interim Power Supply Agreements ("IPSA*s")

On January 19, 2016, after the conduct of a price challenge in compliance with *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed an *IPSA* with 1590 Energy Corporation. The *IPSA* is for the 170 *MW* (firm from February 26 to July 25, 2016; non-firm from July 26, 2016 to February 25, 2017) output from the Bauang power plant – a 215 *MW* bunker oil-fired diesel engine power plant in Bauang, La Union. The term of the *IPSA* is until February 25, 2017, and shall be automatically extended for an additional period of one (1) year up to two (2) times, unless terminated by either party prior to the expiration of its term. The *IPSA* was filed for approval by the *ERC* on February 10, 2016 and shall become effective upon the approval by the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved the *IPSA*. Pursuant to provisions of the *IPSA*, in a letter dated November 10, 2017, *MERALCO* informed 1590 Energy Corporation that it is no longer interested in renewing the *IPSA*, thus, the *IPSA* will only be until February 25, 2018. As at

July 30, 2018, the contract term has expired and *MERALCO* awaits the *ERC*'s final decision on the *IPSA*.

On January 21, 2016, after the conduct of a price challenge in compliance to *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed two (2) separate *IPSA*s with the following wholly owned subsidiaries of *GBPC*, namely; (i) *TPC* for the 28 *MW* (firm) output from its 40 *MW* diesel-fired power plant in Carmen, Toledo City; and (ii) *PPC* for the 45 *MW* (firm) output from its 72 *MW* diesel-fired power plant in La Paz, Iloilo City. The term of the *IPSAs* is until February 25, 2017, and shall be automatically extended for an additional period of one (1) year up to four (4) times, unless terminated by either party prior to the expiration of its term. On February 10, 2016, both *IPSA*s were filed for approval of the *ERC.* In an Order dated April 5, 2016, the *ERC* provisionally approved these *IPSA*s.

On January 26, 2017, considering the imminent Malampaya shutdown from January 28 until February 16, 2017, *MERALCO* agreed to extend the *IPSAs* with *TPC* and *PPC* until February 25, 2018, provided that beginning January 28, 2017, (i) supply from *TPC* and *PPC* will be through replacement energy at a price lower than the contract price and (ii) supply from *PPC* will be on a firm basis until August 25, 2017, and on a non-firm basis from August 26, 2017 until end of the term thereof. All other terms and conditions under the *IPSAs*, as may be approved by the *ERC*, remain the same. Pursuant to provisions of the *IPSA*, in a letter dated November 10, 2017, *MERALCO* informed *TPC* and *PPC* that it is no longer interested in renewing their respective *IPSA*s, thus, the *IPSA*s will only be until February 25, 2018. As at July 30, 2018, the contract term has expired and *MERALCO* awaits the *ERC*'s final decision on the *IPSA*.

On January 24, 2017, in view of the Malampaya shutdown that was to coincide with the scheduled outage of other plants, *MERALCO* signed an *IPSA* with Strategic Power Development Corporation ("*SPDC*") for the supply of 100 *MW* per hour of electric power from 0901H to 1000H and from 2001H to 2100H, and 150 *MW* per hour of electric power from 1001H to 2000H, from January 28, 2017 until February 16, 2017. An application for approval of such *IPSA* was filed before the *ERC* on February 9, 2017. The said *IPSA* was effective immediately, on the condition that disallowances and penalties that the *ERC* may impose as a result thereof shall be for the account of *SPDC. MERALCO* and *SPDC*, in a letter agreement dated February 15, 2017, agreed to extend the term of the *IPSA* until March 25, 2017 under the same terms and conditions of the *IPSA*. On February 16, 2017, *MERALCO* and *SPDC* filed a Joint Manifestation with Motion with the *ERC* apprising the Honorable Commission of the extended term and praying that the same be duly considered and approved accordingly. The hearings on this case have been completed and *MERALCO* filed its *FOE* on July 21, 2017. As at July 30, 2018, the contract term has expired and *MERALCO* awaits the *ERC*'s final decision on the *IPSA.*

CEDC

SMEC

On March 20, 2013, *CEDC* and *SMEC*, as the Independent Power Producer Administrator of the Sual coal fired thermal power plant, entered into a *PSA* through December 25, 2019, unless terminated earlier in accordance with the terms of the Agreement. The initial contracted capacity from the plant was pegged at 55,000 *kWh* which may be increased up to 70,000 *kWh*.

On July 28, 2015, *CEDC* and *SMEC* filed a joint application for the amendment of the *PSA* for "*SMEC* to offer replacement contract capacity and associated energy form other sources, provided, such shall be lower than its forecast replacement power cost from *WESM*".

On September 30, 2016, the *ERC* approved an interim relief to allow *CEDC* to procure additional supply from *SMEC* in light of the planned outage of Sual Unit 1 from October 2016 to November 2016.

With the effectivity of *RCOA*, the various contestable customers shifted their power supply sourcing from the *CEDC* to their respective *RES*. In line with the switching, the *CEDC* and *SMEC* agreed to gradually lower the *PSA* contracted capacity by an aggregate of 40 *MW* in 2017 to manage the electric retail rates of captive customers.

SPDC

On February 20, 2017, *CEDC* executed an agreement for the supply of Contract Electric Energy with *SPDC*, the Independent Power Producer Administrator of the 345 *MW* San Roque Hydroelectric Power Plant in Barangay San Roque, San Miguel, Pangasinan. *CEDC* and *SPDC* agreed that the latter shall supply a total of 25 *MW*, consisting of 20 *MW* firm and 5 *MW* non-firm capacities during Mondays to Saturdays. This *PSA* was entered into by *CEDC* to diversify its source of capacity and also to mitigate its exposure to the *WESM* during the outages of its then lone power supplier, *SMEC*. The *PSA* was jointly filed by *CEDC* and *SPDC* on May 19, 2017 for *ERC* approval. As at July 30, 2018, no decision has been received from the *ERC* with regard to the application.

TransCo/ NGCP

CEDC entered into a Transmission Service Agreement ("*TSA*") with *TransCo* beginning March 30, 2006 until terminated, in accordance with the Open Access Transmission Service ("*OATS*") rules.

In January 2009, by virtue of *RA* No. 9511, *NGCP* has acquired the franchise to engage in *TransCo*'s business of conveying or transmitting electricity. *NGCP* eventually became *CEDC*'s transmission service supplier upon taking over the whole of *TransCo*'s regulated business.

With the termination of the previous *TSA*, *CEDC* executed a *TSA* on December 26, 2013 with *NGCP* for the provision of necessary transmission services in accordance with the *OATS* rules. The term of the *TSA* ends on December 25, 2018.

Interconnection Agreement with Alternergy Wind One Philippine Holdings Corporation ("Alternergy")

On March 1, 2012, *MERALCO* signed an Interconnection Agreement with *Alternergy* for the latter's 90 *MW* wind farm renewable energy plant in Pililla, Rizal, which shall interconnect at *MERALCO*'s Malaya-Teresa 115 *kV* line. *Altenergy* is an embedded generator. *Alternergy* shall construct at its own cost, operate and maintain the 115 *kV* line connecting its generating facility to *MERALCO*'s system. On September 3, 2014, *MERALCO* signed a supplement to the Interconnection Agreement with *Alternergy* to temporarily connect the latter's facilities to *MERALCO's* Malaya-Caliraya 115 *kV* line until December 31, 2015 and thereafter, proceed to the ultimate connection at the Malaya-Teresa 115 *kV* line. In its letter to *MERALCO* dated October 30, 2015, *Alternergy* expressed its intention to extend its use of the 115 *kV* line until the completion of the construction of the Phase 2 Line or until December 31, 2017. In the letter agreement dated December 2, 2015, *MERALCO* and *Alternergy* formalized their agreement regarding the extended use of said line.

Interconnection Agreement with Maibarara Geothermal, Inc. ("*MGI*")

On December 6, 2012, *MERALCO* signed an Interconnection Agreement with *MGI* for the latter's 20 *MW* (with maximum capacity of 40 *MW*) geothermal facility plant in Sto. Tomas, Batangas, which shall interconnect at *MERALCO*'s FPIP - Los Baños 115 *kV* line. *MGI* is an embedded generator. *MGI* shall construct at its own cost, operate and maintain the 115*kV* line connecting its generating facility to *MERALCO*'s system. In its Decision dated September 30, 2013, the *ERC* approved *MGI*'s application for authority to develop, own and operate dedicated point-to-point facilities to connect to the distribution system of *MERALCO*.

Interconnection Agreement with ATN Philippines Solar Energy Group, Inc. ("*ATN*")

On December 8, 2014, *MERALCO* signed an Interconnection Agreement with *ATN* for the latter's 25.2 *MW* solar generating facility in Rodriguez, Rizal, to be connected to *MERALCO*'s Novaliches 44 *YJ*, Diliman 435 *VU* and Parang 412 *YL* circuits. *ATN* is an embedded generator. *ATN* shall construct at its own cost, operate dedicated point-to-point lines and facilities that will connect its generating facility to *MERALCO*'s system. In its Decision dated June 8, 2015, the *ERC* approved *ATN's* application for authority to develop, own and operate a dedicated point-to-point lines and facilities.

Lease Agreement with CDC

On June 23, 2004, *CEDC* entered into a lease agreement with *CDC* for the lease of land and structures for the period of 18 years beginning July 2005, renewable for 25 years upon mutual agreement of both parties.

Beginning July 2004, as stated in the lease agreement, *CDC* charges guarantee fees equivalent to ₱0.05 per *kWh* sold for the first eight (8) years, ₱0.075 per *kWh* for the next four (4) years, and ₱0.12 per *kWh* for the succedding six (6) years.

Investment and Management Agreement with PELCO II

On February 12, 2014, *Comstech* entered into an *IMC* with *PELCO* II for a period of 20 years. *PELCO* II is an electric cooperative with franchise to distribute electric power in certain municipalities of Pampanga.

Pursuant to the *IMC*, *Comstech* shall render technical and management services for the operation, maintenance and management and improvement of *PELCO* II's electric distribution. As consideration for its technical, consultancy and management services, *Comstech* is entitled to a performance-based remuneration and management fee based on a certain percentage of the operating revenues of *PELCO* II.

Agreement and Registration with PEZA

On May 26, 2014, *MERALCO* and *PEZA* entered into a concession agreement for 25 years, whereby *MERALCO* has been contracted to operate the distribution system of *CEZ* beginning May 26, 2014.

On January 24, 2013, *MERALCO* entered into a tripartite agreement with *PEZA* and *Phinma Energy* for the sale of power to *CEZ* and its locators beginning January 26, 2013.

On December 29, 2014, *MERALCO* has secured its Certificate of Registration No.10-01-U from *PEZA*, which confirms *MERALCO* as an Ecozone Utilities Enterprise at the *CEZ*.

30. Earnings Per Share Attributable to Equity Holders of the Parent

Basic and diluted earnings per share are calculated as follows:

	Unaudited			
	For the Six Months Ended June 30		For the Three Months Ended June 30	
	2018	2017	**2018**	2017
	(Amounts in millions)			
Net income attributable to equity holders of the Parent (a)	**₱11,973**	₱10,501	**₱6,661**	₱5,684
Weighted average common shares outstanding (b)	**1,127**	1,127	**1,127**	1,127
Per Share Amounts:				
Basic and diluted earnings per share (a/b)	**₱10.62**	₱9.32	**₱5.91**	₱5.04

Basic and diluted earnings per share amounts are calculated by dividing net income for the period attributable to common shareholders of the parent by the weighted average number of common shares outstanding during the period. There are no potential dilutive common shares in 2018 and 2017.

There are no other transactions involving common shares or potential common shares between the reporting date and the date of completion of these consolidated financial statements.

31. Other Matters

Revised SL Caps

On December 8, 2008, the *ERC* promulgated resolution No.17, Series of 2008 adopting a lower maximum rate of *SL* (technical and non-technical) that a utility can pass on to its customers. The revised *SL* cap is 8.5% for private utilities, starting their January 2010 billing. The said cap is one (1) percentage point lower than the *SL* cap of 9.5% provided under *RA* No. 7832. The actual volume of electricity used by *MERALCO* (administrative loss) is treated as part of the operation and maintenance expense beginning July 2011. The manner by which the utility is rewarded for its efforts in *SL* reduction is addressed by the *ERC* in the Performance Incentive Scheme ("*PIS*") under the *PBR*.

On October 4, 2016, a legislator proposed a bill to lower the current cap of *SL* rate from 8.5% to 5% for private *DU*s and from 13% to 10% for electric cooperatives and to exclude non-technical system losses and electricity used by the private *DU*s and electrical cooperatives from what may be passed on to consumers as *SL* charges. As at July 30, 2018, this proposed bill is still subject for deliberation of the Senate.

On May 9, 2017, the *ERC* posted on its website the draft rules on the Proposed Rules for Setting the Distribution System Loss Cap and Establishing Performance Incentive Scheme for Distribution Efficiency. The *ERC* engaged a third party consultant to conduct the study on the *SL* of *DU*s and propose new caps. Said rules proposed different *SL* caps according to four (4) clusters. Electric cooperatives ("*EC*") were grouped in clusters 1 to 3 and private *DU*s in cluster 4. *DU*s in clusters 1

to 4 have proposed system loss caps of 11.5%, 10%, 7.75%, and 4%, respectively. These caps, which include feeder technical loss and nontechnical loss but exclude sub- transmission and substation technical losses are proposed to be implemented based on the *DU*'s next regulatory reset schedule. For *MERALCO*, the proposed implementation date is July 2019. A series of public consultations and focus group discussions followed, the latest of which was a public consultation for Mindanao stakeholders held in Pasig City on August 9, 2017. In said public consultation, the third party consultant proposed a graduated reduction in system loss caps per cluster. Beginning 2018, *DU*s in clusters 1 to 3 shall have a cap of 12% and *DU*s in cluster 4 shall have a cap of 8%, all of which exclude subtransmission and substation system losses. The caps of cluster 1 to 3 will remain/be lowered to 12%, 10.25%, 8.25% by 2022, respectively. For private *DU*s, the cap will be reviewed based on their submission of annual feeder data to the *ERC*. If private *DU*s fail to submit one (1) year's data (from 2018-2020), its cap in 2022, shall be set at 4.75% excluding subtransmission and substation system losses. The latest proposal of the third party consultant also includes a 1% cap on subtransmission and substation system losses which was not previously capped in the original draft rules.

On February 23, 2018, the *ERC* posted in its website its Rules for Setting the Distribution System Loss ("*DSL*") Cap and Establishing Performance Incentive Scheme for Distribution Efficiency.

The Rules allow for a gradual reduction of Feeder System (Primary and Secondary Distribution System) Loss caps as follows:

Year of Implementation	*EC* Cluster 1	*EC* Cluster 2	*EC* Cluster 3	Cluster 4 (Private *DU*s)
		(in percentage)		
2018	12.00	12.00	12.00	6.50
2019	12.00	11.00	11.00	6.25
2020	12.00	10.25	10.00	6.00
2021	12.00	10.25	9.00	5.50
2022 and onwards	12.00	10.25	8.25	4.75*

*if no annual submission of feeder data.

On May 7, 2018, the *ERC* posted on its website Resolution No. 10, Series of 2018, or "A Resolution Clarifiying the System Loss Calculation and Providing the Effectivity of the Rules for Setting the Distribution System Loss Cap". The Resolution was issued in response to the request for clarification of *EC*s on certain issues regarding the Rules for Setting the *DSL* Cap and Establishing Performance Incentive Scheme for Distribution Efficiency. The Rules for Setting the *DSL* Cap and Establishing Performance Incentive Scheme for Distribution Efficiency was published on the same day. Accordingly, the prescribed system loss cap shall be effective on the next billing cycle of the *DU*s customers.

Subtransmission and substation loss is fully recoverable. However, if *DU*s do not submit monthly metered subtransmission and substation distribution loss data, such losses, as well as distribution feeder losses, will be set to zero in the computation of the recoverable system loss charge. The *DU* may also elect for an individualized *DSL* cap.

Benefit-Sharing Scheme to Lower System Loss

On January 26, 2011, *MERALCO*, together with *PEPOA* and Philippine Rural Electric Cooperative Association ("*PHILRECA*"), filed a joint petition to the *ERC* to initiate rule-making to adopt the Proposed Guidelines for the Implementation of an Incentive Scheme to Lower the System Losses of

Private Distribution Utilities and Electric Cooperatives to Level Below the System Loss Cap, for the Benefit of End-Users. This was aimed to encourage the *DU*s to reduce *SL* levels below the cap set by the *ERC* and benefit the end-users through lower *SL* charges. Public hearings were conducted and completed on June 15, 2011.

On December 11, 2012, the *ERC* posted on its website the second draft of the Rules to Govern the Implementation of a Benefit Sharing to Lower the System Losses of Electric Distribution Utilities. As at July 30, 2018, the Joint Petition is pending further action or decision by the *ERC*.

RCOA

The transition period for *RCOA* commenced on December 26, 2012 in accordance with the joint statement released by the *ERC* and the *DOE* on September 27, 2012 and the Transitory Rules for the Implementation of *RCOA* (*ERC* Resolution No. 16, Series of 2012). The commercial operations of *RCOA* started on June 26, 2013.

On March 31, 2014, the *ERC* issued a resolution on the Withdrawal of the Rules on Customer Switching and the Retention of the Code of Conduct for Competitive Retail Market Participants. On the same date, *ERC* also issued a resolution adopting the Rules on the Establishment of Customer Information by the Central Registration Body ("*CRB*") and Reportorial Requirements, mandating all *DU*s to submit to the *ERC* and *CRB* information on end-users with (i) monthly average peak demand of at least one (1) *MW* for the preceding 12 months; and (ii) monthly average peak demand of 750 *kW* but not greater than 999 *kW*. The *ERC* will use these information in issuing the certificates of contestability.

On October 22, 2014, the *ERC* issued a resolution suspending the issuance of *RES* licenses. Under the resolution, the *ERC* resolves to hold in abeyance the evaluation of *RES* license applications and suspend the issuance of such licenses until such time that the amendments to the Rules for the issuance of *RES* licenses have been made by the *ERC*.

On July 1, 2015, the *DOE* published Department Circular No. DC2015-06-0010, "Providing Policies to Facilitate the Full Implementation of *RCOA* in the Philippine Electric Power Industry". The Circular essentially provided for mandatory contestability.

On March 8, 2016, the *ERC* promulgated Resolution No. 05 Series of 2016 entitled *"*A Resolution Adopting the 2016 Rules Governing the Issuance of Licenses to Retail Electricity Suppliers (RES) and Prescribing the Requirements and Conditions Therefor*"*. The Resolution removed the term local *RES* as one of the entities that may engage in the business of supplying electricity to the contestable market without need of obtaining a license therefor from the *ERC*. Moreover, while an affiliate of a *DU* is allowed to become a *RES*, the allowance is "subject to restrictions imposed by the *ERC* on market share limits and the conduct of business activities".

On May 12, 2016, the *ERC* issued Resolutions No. 10 and 11, Series of 2016, which:

1. Provided for mandatory contestability. Failure of a contestable customer to switch to *RES* upon date of mandatory contestability (December 26, 2016 for those with average demand of at least one (1) *MW* and June 26, 2017 for at least 750 *MW*) shall result in the physical disconnection from the *DU* system unless it is served by the supplier of last resort ("*SOLR*"), or, if applicable, procures power from the *WESM*;

2. Prohibits *DU*s from engaging in the supply of electricity to the contestable market except in its capacity as a *SOLR*;

3. Mandates Local *RES*s to wind down their supply businesses within a period of three (3) years;

4. Imposes upon all *RES*s, including *DU*-affiliate *RES*s, a market-share cap of 30% of the total average monthly peak demand of all contestable customers in the competitive retail electricity market; and,

5. Prohibits *RES*s from transacting more than 50% of the total energy transactions of its supply business, with its affiliate contestable customers.

On May 27, 2016, *MERALCO* filed a Petition before *RTC*-Pasig, praying that: (a) a *TRO* and subsequently a Writ of Preliminary Injunction ("*WPI*") enjoining the *DOE* and *ERC* from implementing the assailed rules be issued; and the assailed rules be declared null and void for being contrary to the *EPIRA* and its *IRR*. In an Order dated June 13, 2016, *RTC*-Pasig granted a 20-day *TRO*, which became effective on June 16, 2016. In an Order dated July 13, 2016, *RTC*-Pasig granted a *WPI*, which became effective on July 14, 2016, and shall be effective for the duration of the pendency of the Petition.

Meanwhile, the *ERC* filed a Petition for Certiorari and Prohibition with prayer for *TRO* and/or *WPI* before the *SC*, which asserted that *RTC*-Pasig has no jurisdiction to take cognizance of *MERALCO*'s Petition, citing Sec. 78 of the *EPIRA*. A similar petition was subsequently filed by the *DOE* before the *SC*.

On October 10, 2016, the *SC*, in relation to the Petition filed by the *DOE*, issued a *TRO* that restrained, *MERALCO*, the *RTC*-Pasig, their representatives, agents or other persons acting on their behalf from continuing the proceedings before the *RTC*-Pasig, and from enforcing all orders, resolutions and decisions rendered in Special Civil Action No. 4149 until the petition before the *SC* is finally resolved. In a Resolution dated November 9, 2016, the *SC* denied *MERALCO*'s *MR*.

On November 2, 2016, in relation to the Petition filed by the *ERC*, the *SC* issued a Resolution dated September 26, 2016, which partially granted the Petition of the *ERC*. While the *SC* allowed the *RTC*-Pasig to proceed with the principal case of declaratory relief, it nonetheless issued a Preliminary Mandatory Injunction ("*PMI*") against *RTC*-Pasig to vacate the preliminary injunction it previously issued, and Preliminary Injunction ("*PI*") ordering the *RTC*-Pasig to refrain issuing further orders and resolutions tending to enjoin the implementation of *EPIRA*. On November 14, 2016, *MERALCO* filed a Motion for Partial Reconsideration with Very Urgent Motion to lift *PMI*/*PI*.

On November 24, 2016, the *ERC* promulgated a resolution moving the contestability date of end users with an average monthly peak demand of at least one (1) *MW* from December 31, 2016 to February 26, 2017. On January 17, 2017, *MERALCO,* through its counsel, received an *SC* Resolution dated December 5, 2016, which consolidated the *SC DOE* Petition with the *SC ERC* Petition. The same resolution also denied the Motion for Partial Reconsideration filed by *MERALCO*.

In relation to the *ERC* and *DOE* Petitions, a separate Petition for Certiorari, Prohibition and Injunction was filed by several institutional customers. In said Petition, said customers sought to declare as null and void, as well as to enjoin the *DOE* and *ERC* from implementing *DOE* Circular No. 2015-06-0010 and *ERC* Resolution Nos. 5, 10, 11 and 28, Series of 2016. Acting on the Petition, the *SC en banc* through a Resolution dated February 21, 2017, issued a *TRO* enjoining the *DOE* and the *ERC* from implementing *DOE* Circular No. 2015-06-0010 and *ERC* Resolution Nos. 5, 10, 11 and 28, Series of 2016. Pursuant to the foregoing, *PEMC* has taken the position that the *TRO* enjoined the voluntary contestability of 750 *kW* to 999 *kW* customers and has not allowed them to switch to the contestable market. The *DOE*, in a press release, has advised that it is in the process, together with *PEMC* and *ERC*, of drafting a general advisory for the guidance of *RCOA* stakeholders. The *PCCI* petition was consolidated with two (2) other separate petitions filed by an educational institution and several *DU*s. The *DOE* and *ERC* have also filed a consolidated comment on these petitions.

On November 29, 2017, the *DOE* issued two (2) *DOE* Circulars, namely: DC 2017-12-0013, entitled, Providing Policies on the Implementation of *RCOA* for Contestable Customers in the Philippines Electric Power Industry and DC 2017-12-0014, entitled Providing Policies on the Implementation of *RCOA* for *RES* in the Philippine Electric Power Industry. The *DOE* Circulars became effective on December 24, 2017.

Under the *DOE* Circular No. DC 2017-12-0013, it is provided that voluntary participation for contestable customers under *RCOA*-Phase 2 shall now be allowed upon effectivity of said Circular, while voluntary participation of contestable customers with a monthly average peak demand of 500 *kW to* 749 *kW* for the preceding 12 months and demand aggregation for electricity end users within a contiguous area with an aggregate average peak demand of not less than 500 *kW* for the preceding 12-month period, will also be allowed by June 26, 2018 and December 26, 2018, respectively.

On December 22, 2017, *MERALCO* wrote *ERC* and *DOE* to seek guidance on the impact of the *DOE* Circulars in the light of the *TRO* issued by the *SC*. On January 17, 2018, the *DOE* responded that there is no legal impediment to the implementation of the *DOE* Circulars but it defers to the *OSG* for guidance on the legal aspect of the issuances. As at July 30, 2018, the *ERC* has yet to respond to *MERALCO*'s letter.

Interim Pre-Emptive Mitigating Measure in the WESM

On May 5, 2014, the *ERC* issued Resolution No 8, Series of 2014, setting an interim pre-emptive mitigating measure in the *WESM*, which established a price threshold in the *WESM* applied over a 72-hour period, which is determined through a rolling average generated weighted average price ("*GWAP*") of ₱8,186 per *MWh*. Also, a secondary cap amounting to ₱6,245 per *MWh* is imposed upon a breach of the threshold, or secondary cap mechanism. Such interim measure aims to mitigate sustained high prices in the *WESM* during the May and June 2014 supply months. On June 16, 2014, the *ERC* issued another resolution extending the effectivity of the pre-emptive mitigating measure for 45 days from expiration or until August 9, 2014. Public consultation and a subsequent focus group discussion were held on July 23 and 25, 2014, respectively. On August 5, 2014, the *ERC* resolved to (i) adopt a permanent pre-emptive mitigating measure that will be applied in the *WESM*; (ii) direct all interested stakeholders to submit their proposed measures within 20 days from effectivity of such resolution; and (iii) extend the effectivity of the secondary cap mechanism for a period of 120 days from August 10, 2014 or until the *ERC* establishes a permanent pre-emptive mitigating measure in the *WESM*, whichever comes earlier.

On September 29, 2014, the *ERC* conducted a public consultation on the proposed permanent pre-emptive mitigating measures in the *WESM*. Parties were then given until October 7, 2014 to file their additional comments, if any.

On October 24, 2014, the *WESM* Tripartite Committee issued a Joint Resolution to further extend the interim offer price cap in the *WESM* for 120 days starting October 24, 2014 to harmonize with the finalization of the permanent pre-emptive mitigating measure which shall be applied in the *WESM*. On February 20, 2015, the *WESM* Tripartite Committee issued a joint resolution which extended further the imposition of the interim *WESM* offer price cap at its current level until September 30, 2015.

In December 2014, in its Resolution No. 20, Series of 2014, the *ERC* adopted and established a permanent pre-emptive mitigation measure in the *WESM*. The *ERC* set a cumulative price threshold ("*CPT*") amounting to an average spot price of ₱9,000 per *MWh* over a rolling 7-day period or 168-hour trading interval. Once this *CPT* for said period is breached, it triggers the imposition of a

price cap amounting to ₱6,245 per *MWh*. The price cap shall be imposed until after a determination that succeeding *GWAP* rolling average is already below the *CPT*. The pre-emptive measure has taken effect beginning January 9, 2015.

The imposition of the mitigating measure was questioned by the Philippine Independent Power Producers Association ("*PIPPA*") in the *RTC*-Pasig through a Petition for Declaratory Relief with Application for *TRO* and/or Writ of Preliminary Injunction. The Petition prayed for, among others, that the *ERC* Resolutions pertaining to the secondary cap mechanism be declared void *ab initio*. The original petition was subsequently amended to reflect the promulgation of the subsequent *ERC* resolutions extending the effectivity of the *WESM* price cap. On July 21, 2014, *MERALCO* filed its Motion for Leave to Intervene and to Admit Attached Comment in Intervention. The *RTC-Pasig* admitted *MERALCO'*s intervention and comment in its Order dated October 28, 2014. However, in a Motion for Leave to Admit Supplement Petition, *PIPPA* moved for leave to file a supplemental petition to include *ERC* Resolution No. 20, Series of 2014 which provides for a permanent mitigating measure in the *WESM*. In an Order dated May 5, 2015, the *RTC*-Pasig denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a Motion for Partial Reconsideration which was denied by the *RTC*-Pasig in its Resolution dated September 10, 2015. *PIPPA* filed a Petition for Certiorari with the *CA*. The *CA* denied the Petition for Certiorari in its Decision dated June 9, 2017. *PIPPA* filed a *MR* dated July 19, 2017. In a Resolution dated August 16, 2017, the parties were directed to file their comments to the *PIPPA*'s *MR*. *MERALCO* has filed its comment on the *MR*. On April 4, 2018, the *CA* rendered a resolution denying the *MR* filed by *PIPPA*.

On September 29, 2015, the *WESM* Tripartite Committee issued a Joint Resolution further extending the interim offer price cap of ₱32,000 per *MWh* until December 31, 2015. In its Joint Resolution No. 3, Series of 2015, the *WESM* Tripartite Committee resolved to set the *WESM* offer price cap at ₱32,000 per *MWh* and the *WESM* offer price floor of negative ₱10,000 per *MWh* effective January 2016, provided that an annual review shall be undertaken considering the relevant costs assumptions at the time of review.

On December 7, 2015, the *RTC*-Pasig rendered a Decision dismissing the Petition for Declaratory Relief. The *MR* filed by *PIPPA* was denied in a Resolution dated June 16, 2016. *PIPPA* appealed the *RTC*-Pasig Decision with the *SC*. *MERALCO* has filed its comment thereto. *PIPPA* filed a Consolidated Reply on July 17, 2017. As at July 30, 2018, the case is pending before the *SC*.

On May 9, 2017, the *ERC* issued Resolution No. 4, Series of 2017, entitled, "A Resolution Adopting Amendments to the Pre-emptive Mitigating Measure in the *WESM*". They adopted a recalculated cumulative price threshold level of ₱1,080,000 and a shorter five (5) -day (120-hour) rolling average period. This is equivalent to ₱9,000 per *MWh* over said period.

PEZA – ERC Jurisdiction

On September 13, 2007, *PEZA* issued "Guidelines in the Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones" and "Guidelines for the Supply of Electric Power in Ecozones" ("*Guidelines*"). Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DU*s which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DU*s in *RTC*-Pasig.

On February 4, 2015, the *RTC*-Pasig issued an Order setting a clarificatory hearing on April 15, 2015. During the said hearing, *MERALCO* manifested that it previously filed a Motion to Withdraw as plaintiff on the basis of letter agreements between *MERALCO* and *PEZA*, which is pending before the *RTC*-Pasig. *MERALCO* submitted the Tripartite Agreement among *PEZA*,

PEPOA and *MERALCO* for approval of the *RTC*-Pasig. In a Decision dated July 3, 2015, the *RTC*-Pasig approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2016, the *RTC*-Pasig dismissed the petition upon motion by *PEZA*. The *ERC* filed a *MR* which is pending resolution by the *RTC*-Pasig.

Purchase of Subtransmission Assets ("*STAs*")

On April 17, 2012, *MERALCO* and *TransCo* filed a joint application for the approval of the Batch 4 contract to sell with the *ERC*. On April 22, 2013, the *ERC* issued a Decision on *MERALCO*'s joint application for the acquisition of the Batch 4 contract to sell. On June 21, 2013 and July 3, 2013, *MERALCO* and *TransCo* filed a Motion for Partial Reconsideration and *MR*, respectively, regarding the exclusion of certain facilities for acquisition.

On May 22, 2014, *MERALCO* and *TransCo* received an *ERC* Order dated May 5, 2014 denying *MERALCO* and *TransCo*'s Motions. On June 5, 2014, *MERALCO* filed a clarificatory motion and a *MR* of the May 5, 2014 *ERC* Order, which was denied by the *ERC* through an Order dated June 16, 2014. On October 10, 2014, *MERALCO* filed a Motion to Reopen Proceedings for the reception of new evidence to support *MERALCO*'s position on the acquisition of excluded *STAs*. The Motion was heard by the *ERC* on October 17, 2014. After the parties have submitted their respective comments and pleadings, the *ERC* conducted another hearing on February 23, 2015. During the hearing, *TransCo* was given three (3) days from the said date to file its Comment on the subsequent pleadings filed, after which the case is deemed submitted for resolution.

In an Order dated March 4, 2015, the *ERC* considered but denied the new and substantive allegations in *MERALCO*'s Motion to Reopen Proceedings. *MERALCO* then filed a Petition for Review with the *CA* to question the Orders of the *ERC*. In a Decision dated August 12, 2016, the *CA* dismissed the Petition. On September 17, 2016, *MERALCO* filed a *MR*. In an Amended Decision dated September 15, 2017, the *CA* granted *MERALCO*'s *MR* and approved the sale of the Dasmarinas-Abubot-Rosario 115 *kV* line and Rosario substation equipment in favor of *MERALCO*. *NGCP* filed a *MR* (of the Amended Decision) dated October 4, 2017. In a Resolution dated May 31, 2018, the *CA* denied the *MR*. *NGCP* filed a Petition for Review with the *SC*. *MERALCO* is currently preparing its Comment to the Petition.

On March 20, 2015, *MERALCO* filed a case for "Interpleader with Consignation and Specific Performance" against *TransCo* and the Municipality of Labrador, Pangasinan ("*Labrador*") with the *RTC*-Pasig, praying for the *RTC*-Pasig to (i) accept and approved the consignation of the amount of ₱194.1 million; (ii) declare *MERALCO* to have paid in full the purchase price of the sale of *TransCo*'s assets; (iii) direct *TransCo* to execute the corresponding Deeds of Absolute Sale; and (iv) direct *Labrador* and *TransCo* to interplead their respective claims. On April 14 and 20, 2015, *Labrador* and *TransCo* filed their respective Motions to Dismiss on the ground of impropriety of the filing of the Interpleader and on the ground of *litis pendentia*. *MERALCO* received an Order from *RTC*-Pasig granting the Motions to Dismiss of both *TransCo* and *Labrador*. *MERALCO* filed a *MR* which is pending resolution. In a Letter dated December 27, 2017, *Labrador* denied *TransCo*'s request for settlement of the warrant of distraints issued by said city against *TransCo*'s properties, including the subject properties for local business tax claims. As at July 30, 2018, *MERALCO* is awaiting for *CA*'s decision before any action may be taken in relation to the contract to sell.

On December 15, 2016, *MERALCO* and *TransCo* filed a joint application for the approval of the Batch 3 contract to sell with the *ERC*. The case is set for initial hearing on August 10, 2018.

FiT

Pursuant to *RA* No. 9513, or the Renewable Energy Act of 2008 ("*RE* Act"), the *ERC* issued Resolution No. 16, Series of 2010, Adopting the *FiT* Rules, on July 23, 2010. As defined under the *FiT* Rules, the *FiT* system is as a renewable energy policy that offers guaranteed payments on a fixed per *kWh* for electricity from wind, solar, ocean, hydropower and biomass energy sources, excluding any generation for own use.

On May 16, 2011, the National Renewable Energy Board ("*NREB*") filed its Petition to Initiate Rule Making for the Adoption of *FiT*. The Petition proposed a specific *FiT* Rate for each emerging renewable resource. On July 27, 2012, after undergoing several public consultations and public hearings, the *ERC* approved *FiT* Rates lower than the rates applied by the *NREB*.

To fund the *FiT* payments to eligible *RE* developers, a *FiT-All* charge shall be imposed on all end-users. The *FiT-All* will be established by the *ERC* upon petition by *TransCo*, which had been designated as the *FiT* Fund Administrator.

On February 5, 2014, the *ERC* released the *FiT-All* disbursement and Collection Guidelines ("*FiT Guidelines*") to supplement the *FiT* Rules. This set of guidelines will govern how the *FiT-All* will be calculated using the formulae provided. It will also outline the process of billing and collecting the *FiT-All* from the electricity consumers, the remittance to a specified fund, the disbursement from the *FiT-All* fund and the payment to eligible *RE* developers.

On July 30, 2014, *TransCo* filed its Application for Approval of the *FiT-All* for calendar years 2014 and 2015. On October 7, 2014, the *ERC* provisionally approved a *FiT-All* of ₱0.0406 per *kWh* effective in the January 2015 billing as a separate line item in the bills of end consumers. In its letter to *MERALCO* dated December 18, 2014, the *ERC* clarified that the January 2015 billing covers consumption of customers for the period December 26, 2014 to January 25, 2015.

On December 23, 2014, *MERALCO* received a copy of a Petition for Prohibition and Certiorari filed with the *SC* against the *ERC*, *DOE, TransCo*, *NREB* and *MERALCO*. The Petition seeks (i) the issuance of a *TRO* and/or *WPI*, and after giving due course to the Petition, a Writ of Prohibition to enjoin the respondents from implementing the *FiT-All*, the *FiT* Rules and *FiT* Guidelines; and (ii) the annulment of the *FiT* Rules and *FiT* Guidelines. The parties have been directed to submit their respective memoranda.

On April 30, 2014, the *DOE* issued a certification revising the installation target for solar from 50 *MW* to 500 *MW*, an additional capacity of 450 *MW*. In its certification, the *DOE* stated that "solar energy generation projects given their short installation period can greatly contribute in providing additional generating and reserve capacity in the summer seasons of 2015 and 2016".

On January 28, 2015, the *ERC* conducted a public consultation on the increase of the installation target for solar renewable energy generation (additional 450 *MW*) and the *FiT* Rate for the additional solar capacity. In the said hearing, it was clarified that the additional 450 *MW* installation capacity for solar is already approved by the *DOE*. On April 28, 2015, the *ERC* issued a Decision dated March 27, 2015 setting the new solar *FiT* Rate at ₱8.69 per *kWh*, which shall apply prospectively.

On April 7, 2015, the *DOE* issued a certification revising the installation target for wind from 200 *MW* to 400 *MW*. On April 13, 2015, the *ERC* initiated the review of the *FiT* for wind technology. In a letter dated April 15, 2015, the *ERC* directed the *NREB* to submit a proposal regarding the review of *FiT* for wind technology beyond the original 200 *MW* installation target. The *NREB* proposed a Wind *FiT* of ₱8.49 per *kWh*. On July 30, 2015, the *ERC* conducted a public consultation on the new

proposed Wind *FiT*. In a Decision dated October 6, 2015, the *ERC* set the Wind *FiT* at ₱7.40 per *kWh. MERALCO* filed a *MR* on the Decision. As at July 30, 2018, the *MR* is pending further action of the *ERC*.

On December 22, 2015, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2016. In an Order dated February 16, 2016, the *ERC* provisionally approved a *FiT-All* of ₱0.1240 per *kWh* effective in the succeeding billing period after *TransCo* received the Order. The *FiT-All* was implemented starting April 2016 billing month. In a Decision dated May 9, 2017, the *ERC* approved the final *FiT-All* for calendar year 2016 of ₱0.1830 per *kWh* effective in the succeeding billing period after *TransCo* received the Decision. The final *FiT-All* rate was implemented starting June 2017 billing.

On September 29, 2016, Alternergy Wind One Corporation, Petrowind Energy, Inc. and Trans-Asia Renewable Energy Corporation filed a Petition to Initiate Rule-Making to adjust the Wind *FIT* rate of ₱7.40 per *kWh* to ₱7.93 per *kWh*. *MERALCO* filed an intervention in the case. The hearing on the Petition was set on January 6, 2017. *MERALCO*'s motion on the propriety of the petition has been submitted for the resolution of the *ERC*.

On December 1, 2016, *TransCo* filed for an application with the *ERC* seeking to collect a *FiT-All* rate of ₱0.2291 per *kWh* for 2017. In a Decision docketed May 11, 2018, the *ERC* approved the final *FiT-All* for calendar year 2017 of ₱0.2563 per *kWh* effective in the succeeding billing period after *TransCo* received the Decision. The final *FiT-All* rate was implemented starting June 2018 billing.

On August 30, 2017, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2018 seeking to collect a *FiT-All* rate of ₱0.2932 per *kWh*. As at July 30, 2018, the case has been submitted for decision of the *ERC*.

On July 27, 2018, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2019 seeking to collect a *FiT-All* rate of ₱0.2780 per *kWh,* effective January 2019 billing.

Recovery of National Power Corporation's ("NPC") Stranded Contract Costs

In an Order dated May 22, 2018, the *ERC* approved *PSALM*'s petition for the recovery of *NPC*'s stranded contract costs portion of the universal charge. Accordingly, *PSALM* is hereby authorized to recover the stranded contract costs for Luzon, Visayas and Mindanao grids totaling ₱8,547 million with a monthly rate of ₱0.1938 per *kWh* starting May 2018 billing period until the full amount has been recovered.

Net Metering Program

The *RE* Act mandates the *DU*s to provide the mechanism for the "physical connection and commercial arrangements necessary to ensure the success of the *RE* programs", specifically the Net Metering Program. The *RE* Act defines Net Metering as "a system, appropriate for distributed generation, in which a distribution grid user has a two-way connection to the grid and is only charged for his net electricity consumption and is credited for any overall contribution to the electricity grid". By their nature, net metering installations will be small (less than 100 *kW*) and will likely be adopted by households and small business end-users of *DU*s.

After consultations with stakeholders, the *ERC* issued on July 3, 2013 its Resolution No. 09, Series of 2013, entitled, "A Resolution Adopting the Rules enabling the Net Metering Program for Renewable Energy". The Rules will govern the *DUs*' implementation of the Net Metering Program. Included in the Rules are the interconnection standards that shall provide technical guidance to

address engineering, electric system reliability, and safety concerns for net metering interconnections. The final pricing methodology, however, will be addressed in another set of rules and will be endorsed to the *ERC* in due course. In the meantime, the *DU*s' blended generation cost equivalent to the generation charge, shall be used as the preliminary reference price in the net metering agreement. The Rules took effect on July 24, 2013. As at June 30, 2018, *MERALCO* has already installed 1,451 meters and energized 1,340 net metering customers.

Interruptible Load Program ("*ILP*")

In an *ERC* Order dated April 11, 2014, the *ERC* approved with modification *MERALCO*'s request that it be allowed to adopt and implement the *ILP*. *ILP* protocols, compensation and recovery mechanism are governed by *ERC* Resolution No. 5, Series of 2015 "A Resolution Adopting the Amended Rules to Govern the Interruptible Load Program" and *DOE* Circular No. DC2015-06-0003 "Providing the Interim Manner for Declaring Bilateral Contract Quantities in the Wholesale Electricity Spot Market and Directing the Philippine Electricity Market Corporation to Establish Necessary Protocols to Complement the Interruptible Load Program".

As at June 30, 2018, there are 153 companies with a total committed de-loading capacity of 576 *MW* that have signed up with *MERALCO*, *MPower* and with other retail electricity suppliers as *ILP* participants.

Long-Term Indebtedness Application

On June 25, 2015, *MERALCO* filed an application, with prayer for provisional authority, for continuing authority to (a) issue bonds or other evidence of indebtedness for as long as it maintains 50:50 long-term debt to equity ratio; and (b) whenever necessary, to mortgage, pledge or encumber any of its property to any creditor in connection with its authority to issue bonds or any other evidence of long-term indebtedness. The hearing on the application was conducted on October 6, 2015. In an Order dated October 12, 2015, the *ERC* directed *MERALCO* to submit additional documents in support of its application which *MERALCO* complied with. However, due to changes in the financial climate which may affect the terms and conditions of any financial borrowings, *MERALCO* has filed a Motion to Withdraw the application without prejudice to its refiling at a later date. In an Order dated March 22, 2016, the *ERC* granted *MERALCO*'s Motion to Withdraw but still required *MERALCO* to submit certain documents. *MERALCO* filed a Motion for Partial Reconsideration questioning the requirement which is pending before the *ERC*. As at July 30, 2018, the *ERC* has yet to resolve *MERALCO*'s Motion for Partial Reconsideration.

Prepaid Retail Electricity Service ("*PRES*")

On December 12, 2014, *MERALCO* filed an application for authority to offer and provide *PRES* to its customers as well as the applicable rules to govern *PRES*. In a Decision dated April 27, 2015, the *ERC* approved the application with modification. As at June 30, 2018, there are 95,731 customers availing of *PRES*.

CSP for Power Supply Agreements

As early as February 2013, the *ERC* posted the first draft of rules on *PSA* approval, solicited comments from stakeholders thereon and conducted various focused group discussions. Said draft required *DU*s to undergo *CSP* in their supply procurement, required a specific procedure for such and prescribed a *PSA* template.

Meanwhile, in October 2014, the *DOE* issued for comments its draft Circular on Demand Aggregation and Supply Auctioning Policy ("*DASAP*"). This was likewise subjected to public consultations.

In June 2015, *DOE* promulgated *DOE* Circular No. 2015-06-0008, "Providing Policies for Further Enhancement of the *WESM* Design and Operations", prescribing *DU*s to procure all its uncontracted demand through *CSP*, through the participation of a third party and which may be done by *DU*s on an aggregated basis. The *DOE* Circular gave *DOE* and *ERC* 120 days to issue the necessary Implementing Guidelines ("*IG*"). Instead of issuing an *IG*, in a Joint Resolution dated October 20, 2015, it was agreed by *DOE* and the *ERC* that the latter shall be the one to issue the relevant *CSP* regulations. On the same date, the *ERC* promulgated Resolution No. 13, Series of 2015.

ERC Resolution No. 13, Series of 2015 included the following provisions:

- All *DU*s are required to undergo *CSP*. Pending the *ERC's* issuance of a prescribed process, *DU*s may adopt any accepted form of *CSP*, provided that the terms of reference shall include, among others, the following – (a) contract capacity or energy volume, (b) generation source, (c) method of fuel procurement, (d) contract period, (e) tariff structure, (f) Philippine peso or foreign currency denominated payment, (g) penalties, (h) applicable transmission projects, and (i) other key parameters.

- A *CSP* is successful if there are at least two (2) qualified bids. Should there be at least two (2) failed bids, then a *DU* can proceed with direct negotiation.

- The *CSP* requirement shall apply to *PSA*s that although executed, have not yet been filed for approval before the *ERC*.

On March 15, 2016, the *ERC* released Resolution No. 1, Series of 2016 entitled, "A Resolution Clarifying the Effectivity of *ERC* Resolution No. 13, Series of 2015". In this new Resolution, the *ERC* clarified that after judicious study and due consideration of views raised by different industry stakeholders, it has resolved that:

- The effectivity of *ERC* Resolution No. 13, Series of 2015 is hereby restated to be April 30, 2016.

- On the other forms of *CSP* referred to in Section 2 of the *ERC* Resolution No. 13, Series of 2015, these should likewise comply with the minimum terms of reference and the requirement of at least two (2) qualified bids for the *CSP* to be considered successful.

In reference to *PSA*s with provisions allowing the automatic renewal or extension of their term, *PSA*s that were previously approved by the *ERC* or filed with the *ERC* before the effectivity of this Resolution may have one (1) automatic renewal or extension for a period not exceeding one (1) year from the end of their respective terms. Upon effectivity of this Resolution, automatic renewal clauses or extension of *PSA*s shall no longer be permitted.

On November 18, 2016, *MERALCO* received a copy of the Petition dated April 28, 2016 filed by a consumer group in the *SC* against the *ERC*, *DOE*, *MERALCO*, *Central Luzon Power*, *St. Raphael*, *PEDC*, *Mariveles Power*, *A1E*, *RP Energy* and the Philippine Competition Commission which sought to declare as void Resolution No. 1, Series of 2016 and to mandate the *ERC* to disapprove all *PSA* applications for failing to comply with the *CSP* requirement. In a Resolution dated November 16, 2016, the *SC* directed all parties to comment on the Petition. *MERALCO* has filed its

comments to the Petition. In a Resolution dated June 17, 2017, the petitioners were directed to file their replies to the comments filed by respondents.

On February 9, 2018, the *DOE* published *DOE* Circular No. DC2018-02-0003, entitled, "Adopting and Prescribing the Policy for the Competitive Selection Process in the Procurement by Distribution Utilities of Power Supply Agreements for the Captive Market". Upon effectivity of the Circular, all prospective *PSA*s in grid and off-grid areas shall be procured through *CSP*.
The *CSP* under the Circular involves publication of invitation to bid, pre-bid conference, bid evaluation, and pre-/post-qualification of winning bidder. Exemption from *CSP* may be granted by the *DOE* in the following instances:

i. Generation project owned by the *DU* funded by grant or donations
ii. Negotiated procurement of emergency supply
iii. Provision of supply in off-grid areas prior to the entry of New Power Providers
iv. Provision of supply by PSALM through bilateral contracts for power produced from undisposed generating assets and *IPP* contracts sanctioned by *EPIRA*

*PSA*s that were granted exemption from *CSP* shall be implemented by the *DU* immediately without prejudice to the evaluation and final decision of the *ERC*.

The *DU*'s *CSP* may be managed by a Third Party Bids and Awards Committee ("*TPBAC*") or a Third Party Administrator ("*TPA*"). Each *CSP* shall be completed within five (5) months from the time of the publication of the Invitation to Bid until submission of the *PSA* to the *ERC*.

Direct negotiations may be made by the *DU*s after at least two (2) failed *CSP*s and there is no outstanding dispute on the conducted *CSP*. A *CSP* is considered failed when during its conduct:

i. No proposal was received by the *DU*
ii. Only one (1) generator submitted an offer
iii. Competitive offers of prospective generators failed to meet the requirements prescribed in the bid document

Within 60 days upon effectivity of the Circular, the *ERC* shall develop rules and procedures to:
(i) support the Circular, including guidelines for *TPA* accreditation and a *PSA* template, and
(ii) address disputes arising from the conduct of the *CSP*. On April 26, 2018, the *ERC* posted in its website the draft "Rules Governing the Execution, Review and Evaluation of Power Supply Agreements ("*PSA"*) Entered into by Distribution Utilities for the Supply of their Captive Market". *ERC* has conducted a public consultation and received comments thereon. As at July 30, 2018, *MERALCO* is awaiting the rules and procedures to be promulgated by the *ERC*.

32. Event After the Financial Reporting Date

On July 30, 2018, the *BOD* of *MERALCO* approved the declaration of cash dividends of ₱5.31 a share to all shareholders of record as at August 29, 2018, payable on September 24, 2018.